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THE LAW IN BUSINESS PROBLEMS

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MELBOURNE

THE MACMILLAN CO. OF CANADA, LTD.
TORONTO

The Law in Business Problems

CASES AND OTHER MATERIALS FOR THE STUDY OF LEGAL ASPECTS OF BUSINESS

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New York
THE MACMILLAN COMPANY
1921

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Set up and electrotyped. Published July, 1921

Printed in the United States of America

PREFACE

The conventional excuse is no doubt expected for adding a book on a subject on which a library has already been written. It is simply that this book is very different from the others in its point of view and methods.

If authority is needed for the obvious proposition of business policy as well as of law, that to disparage the wares of another is not a legitimate way to advertise one's own, it is contained in this book (§§45, 46). As a matter of fact, we do not need this warning, since we see much to praise and admire in the long line of works on business law; from that of Malynes down through the works of Jacob, Beawes, Story, Smith, Parsons, Huffcut and several distinguished living authors, to the great unfinished collection of the Commercial Laws of the World, further progress on which has been unhappily arrested by the war.

It is no disparagement of these works to say that none of them fills a particular niche whose importance has been constantly brought home to us by our experience in the teaching of commercial law in collegiate schools of business. What has not been done to any considerable extent is to deal with legal rules from the standpoint of business. This book aims, in common with the others, to give some understanding of the legal rules governing the more familiar business transactions and business relations, but its principal concern is to show the legal system in its relation to the problems and policies of business administration. It is not an "elementary" law book. Possibly it may be thought by some not to be a law book at all. It is intended for mature and intelligent readers and students whose chief interest lies in the field of business, whether or not they have any special knowledge of law. In fact, however, the law-trained man may find it a particularly convenient bridge for crossing the gap that tends to separate the law in books from the law in business. He may find the point of view presented here of in-

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terest to him even as a lawyer—for the lawyers of today aim rather to be business caretakers and expert counsellors than eloquent advocates such as their grandfathers wished to be. Reflection on these business problems suggests to the lawyer, now and then, a living business origin for legal propositions—an explanation which affords a welcome substitute for the game of hide-and-seek with an hypothesis which some one may have conjured up. (*Cf.* for example §§12, 13, 52, 197, 229, 270, 341.) And if he is inclined to look forward rather than backward, certainly the actual workings of the law in business are a consideration of prime importance.

To the lawyer who ventures into these pages, some of the juxtapositions will seem odd and more puzzling than to his business client, just because in the lawyer's study of legal concepts he has never had occasion to bring together widely divergent parts of the law for comparison in concrete business problems in which they happen to present alternative solutions. To the lawyer there is very little in common, unless he has mastered the rare art of seeing through the dead rule to the living reality beyond, in a contract requiring a deposit from an employee, a criminal prosecution for embezzlement, and a surety bond. Yet, as modes for enforcing responsibility of employees for money entrusted to their care, it is a practical business problem to compare their workings. A cynic may ask, "Why not add the cash register to the list?" The joke is not without its point, for the law is not the only means that man can devise for serving particular ends, and to the business man it is only by reference to these ends that the law assumes a real interest and an immediate importance. We have, accordingly, endeavored to "anatomize" business, as an old writer on business law once said, and study the part played by the law in this anatomy. Does the law help or hinder or otherwise affect the process of engaging in business? How does it stand by, when the trader makes represention to the public and when he negotiates and closes bargains with individual members of that public? What function does the law play in enforcing the mutual obligations of business man and customer? What effect has the law on those internal problems of a business which we may roughly call business

organization? None of the books, so far as we are aware, approaches the entire subject from this particular angle.

As to our method, we have simply endeavored to present teachable materials. Much of it is in the form of cases, some of which are as useful and interesting for their power to throw light on "how things happen" as they are for their *rationes decidendi*. But we have by no means permitted the dogma of a single method to stand between us and the reader, where we felt that we had something to say to him directly, especially in the first part of the book, after mastering which the student will be better prepared to use case material. Gradually the proportion of this editorial text is allowed to diminish so that the later chapters are made up of cases and just enough connective tissue to guide the student and preserve the readability of the book for others.

The liberal use we have made of learned notes and articles taken from the technical law reviews may seem surprising in a book for laymen. It is our sincere hope that the passages will speak for themselves and demonstrate the possible value of a good law journal to the business man who wants to keep *au courant* in his own field. In the present state of our legal literature the journals are the repositories of our best thought in business law as well as other fields of jurisprudence.

Anything like a complete presentation of American business law within the compass of a volume is an impossible achievement and—in a land so well supplied with public libraries and trained lawyers—a thoroughly useless undertaking. Besides, there are forty-eight state legislatures and a Federal Congress (to say nothing of ever so many schemes of initiative and referendum and law-making courts and commissions), conspiring day and night to make such a book obsolete before it gets through the press. A close, analytic examination of a huge welter of discordant rules is therefore not within the aim of the present undertaking. The type of book demanded by non-professional readers may be described as one that contains a clear, sound, and fairly adequate discussion of the legal aspects of the funda-
indication of the extent to which the usual or standard rule of

law is in force throughout the entire country—or even throughout the civilized world. For business law is the branch of law to which Cicero's famous words quoted by Lord Mansfield, in *Luke v. Lyde,* 2 Burr. 887, are peculiarly applicable: *Non erit lex alia Romae, alia Athenis, alia nunc, alia posthac, sed et apud omnes gentes et omni tempore una eademque lex obtinebit.* Let this be our excuse for occasionally dipping into foreign systems for comparison.

While a collection of legal forms would doubtless prove a convenience to a certain number of readers, it is not thought advisable to enlarge the size of the volume with this kind of material. Those interested will generally have no difficulty in securing access to one of the comprehensive books on legal forms, as well as to certain of the law blanks which are locally in common use. It is rather dangerous in the present state of the law to carry such forms across state borders, as several great business houses have learned to their chagrin when their activities, originally exclusively local, became national in their scope.

All that *can* be accomplished with the aid of a book such as this is to help the student acquire a useful point of view, familiarity with some fundamental legal conceptions, training in thinking on legal propositions, and the power of applying such thought in the solution of concrete business problems. The problems, interspersed with the text and case material, will, it is hoped, help in this last and crowning purpose of the book.

Our obligations to writers of texts and compilers of casebooks as well as editors and publishers of periodicals are too numerous to mention as well as too obvious to require mention. So far as possible they have been indicated in the text and notes. We wish to record, however, one debt of gratitude, that owing to Professor George J. Thompson, of the University of Pittsburgh, for his numerous suggestions and painstaking reading of the proofs.

L. F. S.
N. I.

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TABLE OF CASES

[Cases reported are indicated in small capitals; cases cited, in italics; and cases discussed or quoted in ordinary type.]

The Use of a Table of Cases.—(1) Law books generally are indexed by means of tables of cases so that if one case on a particular point is found, it may serve as a key to all related cases in the same and in other jurisdictions. (2) Such a table is also helpful in tracing the *post-mortem* history of a case—that is to say, to discover instances in which the case has been criticized, distinguished, explained, followed, harmonized, limited, overruled, paralleled, or questioned. Thus, the English case of *Hadley v. Baxendale*, which is reported on page 386, is explained in a later decision, and its application somewhat limited in a later case on pages 390 and 391. It is cited on pages 395 and 396 as a leading authority in a still later case in the Supreme Court of the United States. (3) As a means of cross reference from one law book to another, the use of a table of cases is sometimes mechanically more convenient, as well as more accurate in its results than the ordinary topical index because legal nomenclature differs from state to state and from time to time.[1] (4) Likewise, it aids in cross reference from one part of the book to another. The law cannot be separated into water-tight compartments. Thus, the case of *Byrne v. Van Tienhoven*, which is reported on page 140 to illustrate the extent to which the court regards a "state of mind" as an operative fact in the making of contracts, is cited on page 642 to show the relevancy or irrelevancy of such a "state of mind" in connection with ratification of the acts of an agent.

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[1]For a complete list of all cases reported in the United States up to 1906, together with references to all the places in which each case is reported, and an indication (the "key number") of the places where the respective cases are digested in the American Digest system, see the last five volumes of the first Decennial Digest of that system published by the West Publishing Co. Later units of that system (decennial, annual and monthly, bringing the digest of American law down to date) contain similar indexes of cases for the periods covered.

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INTRODUCTORY TOPICS

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CHAPTER I

NATURE AND SOURCES OF THE LAW

§1. *The Law of the United States.*—All nations of the Western type of civilization are now governed by law which bears the stamp of either the Roman, or the English legal system.

The law of Rome, under the name of "modern civil law," furnishes the frame work, if not the content of the legal system of the continent of Europe, and also of the Latin-American countries, Scotland, Quebec, South Africa and Louisiana (although the law of the last four jurisdictions is by no means all civil law).

English law, also known as "the common law," is of Anglo-Saxon parentage. The Roman occupation of Britain left no mark on its laws. The Norman Conquest in 1066, on the other hand, exercised a profound influence on its system of land law by crystallizing the feudal system and at the same time establishing a strong centralized government at its head. On the whole, however, it may be said that the work of developing a distinctive legal system for England did not begin until the end of the twelfth century when the king's judges began to establish a general or common law for the whole realm. This system now prevails not only in England and Ireland, but also in Canada (except Quebec), Australia, and other British territories settled by the English.[1] Moreover, it is the basal law in all jurisdictions of the United States (except Louisiana, Porto Rico, and the Philippines). For this reason it is sometimes referred to as the Anglo-American law.

Although the English common law became the foundation for the legal system of all save one of our states, its doctrines

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[1]Unlike the Roman law, English law has been spread, as a rule by settlement, not by conquest. There are many British dependencies in which the native laws and customs have not been disturbed.

have always been applied only so far as they were suited to American conditions. In the words of Justice Story, "Our ancestors brought with them its general principles and claimed it as their birthright; but they brought with them and adopted only that portion which was applicable to their situation."[2] A study of Anglo-American law, therefore, includes not only the doctrines of the parent system, but also the variations from these doctrines which have been made in America from time to time.

Each of the American states is an independent legal unit. This multiplicity of jurisdictions makes all but inevitable the existing bewildering diversity in the decisions and statutes of the various states. Moreover, under the American system of state and federal courts there is frequently a conflict of decision between state and federal courts. There is a provision in the Constitution that in controversies between citizens of different states the jurisdiction of the federal courts is concurrent with that of the state courts;[3] and the decision of the United States Supreme Court in *Swift v. Tyson*,[4] has made it clear that in the exercise of this jurisdiction with respect to matters of "general commercial law," not yet completely defined, the federal courts may disregard the views of the courts of the state in which the action arises. It frequently happens, therefore, that the decision of a case growing out of a business dispute depends upon the chance circumstance of the forum in which the case is tried.

§2. *Characteristic Features of the Common-Law System.*—In a large way it may be said that there are four well-defined differences between the common-law and the civil-law systems.

First, in jurisdictions where the common law prevails the jury functions as part of the ordinary administration of the law. It plays a decisive part in the settlement of disputed

[2]*Van Ness v. Pacard* (1829) 2 Peters (U. S.) 137, 144, per STORY, J.

[3]At the present time the jurisdiction of the federal courts on the ground of diversity of citizenship is exercisable only where the amount involved is $3000 exclusive of interest and costs. See the Judicial Code of March 3, 1911, 36 Stat. at L. 1087.

[4](1842) 16 Peters 1.

questions of fact in all kinds of litigation, except suits in equity.[1] In the civil-law countries, trial by jury takes place only in a criminal case; it is not an incident of any civil action by which the legal claims of private individuals are enforced.

The historic causes which many centuries ago made trial by jury an institution peculiar to England cannot here be reviewed.[2] The degree of present-day usefulness of this old institution is perhaps appraised more skeptically today than was true when our various state constitutions were adopted. Nevertheless, juries are unquestionably useful whenever litigation involves standards of conduct. A more dubious advantage of having juries is set forth by Mr. Justice Holmes, who states that "they will introduce into their verdict a certain amount—a very large amount so far as I have observed—of popular prejudice, and thus keep the administration of the law in accord with the wishes and feelings of the community."[3] Finally, it is worthy of remark that the jury system, even when regarded not as a sacred and fundamental right but merely as a method of legal procedure, serves as one of the bulwarks of free institutions. In the words of Mill in his essay on Liberty, jury trial comprises part of "the peculiar training of a citizen, the practical part of the political education of a free people, taking them out of the narrow circle of personal and family selfishness, and accustoming them to the comprehension of joint interests, the management of joint concerns—habituating them to act from public or semi-public motives, and guiding their conduct by aims which unite instead of isolating them from one another."

It would be a poor way of defending the jury system to deny that it is without its drawbacks. Shortcomings of course exist, especially under the American practice which limits the judge's charge to little more than a statement of abstract principles of law. The element of popular prejudice is not without its dangers of abuse, particularly in those personal injury cases

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[1]In an equity suit the verdict of a jury on disputed facts is merely advisory and not binding upon the court.

[2]The student is referred to Jenks, *Short History of English Law*, 47, for a concise statement of the history.

[3]*Law in Science and Science in Law*, 12 Harv. L. Rev. 443, 460.

in which a corporation is the defendant. Nevertheless, while trial by jury has been modified in some states, its entire abolition is decidedly improbable. Its maintenance is guarantied not only by constitutional provisions but also by the spirit of equality and personal liberty, and the well-entrenched democratic institutions which have come to be such powerful influences in modern times.[4]

In the second place, the principle is thoroughly established in all common-law countries that all executive power is strictly limited by the ordinary or common law. All persons are judged by the same tribunals, and are subject to the same rules. On the other hand, in countries governed by the civil law, numerous classes of government officials come under the rules of a separate, independent system known as "administrative law," and executive or administrative acts are dealt with, not by the ordinary courts of justice, but by special administrative tribunals.

The binding force which is given to principles underlying the decisions of judges is a third peculiarity of the common-law system.[5] Judicial decisions are practically of imperative authority as regards both the court that renders the decision and every court inferior to it.[6] In the Roman law, such a doctrine of judicial precedent is unknown. In countries which have derived their law from the Roman system judicial single decisions are not binding authorities for the future, though the

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[4]See §246, *infra.*

[5]The written opinions of judges giving the reasons for their decisions are compiled in volumes known as law reports. The reports of the various English courts now number over 3500 volumes, while the law reports in this country now constitute about 9500 volumes.

[6]For a discriminating discussion of the reason and scope of the doctrine of *stare decisis* (to abide by decided cases), see the opinion of Rugg, J., in the case of *Mabardy v. McHugh* (1909), 202 Mass. 148, 151, 152. Of course, a court has the power to overrule its own decision when the decision is shown to be ill-considered, opposed to the analogies of the law or unjust. "It is going quite too far to say that a single decision of one court is absolutely conclusive as a precedent. It is an elementary principle that an erroneous decision is not bad law; it is no law at all." Per Bronson, J., *Butler v. Van Wyck* (1841), 1 Hill (New York), 462-463. But the settled course of decision on any particular point *is* the law, or at least the best evidence of the law, whether we speak of the courts as the originators of the rules of law, or prefer to abide by the formulæ of the profession, which pretend to see in the court's activity a mere declaration of what has always been the law, though never before declared.

settled uniform practice of a tribunal has much the same force as a precedent with us, or at least a somewhat stronger persuasive influence than that which judges in common-law jurisdictions have been willing to concede to standard treatises, and to the *obiter dicta* of judges.

Finally, the law of nearly all jurisdictions whose law is based upon the common law of England is pre-eminently judge-made law, or in other words, law derived from adjudication. In civil-law countries the entire field of private law has been scientifically arranged and promulgated by legislative authority in what are termed codes.[7] The desirability of codifying the whole body of the law of a state has been and still is a much-debated question.[8] On the one hand, it is undeniable that the unsystematic character of case-law discourages the synthesis of legal principles along scientific lines. Moreover, the appalling multiplication of law reports in our own day frequently makes it a task of great difficulty to find out what the law really is. On the other hand, however, judge-made law is not only apt to be superior to statute law because it is produced slowly, gradually, and only after arguments made under the stimulus of personal interest, but it also provides a great wealth of detailed rules for situations which the most far-sighted legislator could not have foreseen. Of course, even a system of case-law may be wisely supplemented by a certain amount of legislation. The principle of binding precedents almost forces judges to invent a "distinction" which does not involve any appreciable difference in order to get rid of an ill-decided case, and the natural reluctance of courts to resort to this method

[7]It is deserving of mention that the administrative or public law in countries governed by the civil law has never been codified. It has even been suggested that administrative law in France reached its present proportions through an attempt to supplement the code by a resort to the fiction that the matters involved in administration were not private law. *Cf.* Alvarez, in *Progress of Continental Law in the Nineteenth Century*, p. 25.

[8]There is, however, little disposition in common-law countries to do away with the principle of the authority of precedent, which, despite its obvious disadvantages, has the conspicuous merit of giving a high degree of certainty to the law. No matter how far the movement towards codification may proceed in the future, it is altogether likely that decisions interpreting the code will be accepted as controlling future cases.

tends unduly to prolong the life of ancient rules unsuited to new conditions. For this reason a period of rapid social change is apt to give rise to much legislation of the type which aims at the abolition or modification of so much of the traditional judge-made law as is out of touch with the practical demands of that period. It is also true that in modern times England and most American states have seen fit to codify considerable portions of their law, particularly certain important topics of commercial law.[9] Nevertheless, it is still true in nearly all these jurisdictions that a very large part of the law, in fact most of it, is derived from adjudication, not from legislation.[10]

§3. *Assimilation of the Law Merchant into the Common-Law System.*—In primitive law, the legality of an act is subject to one test—its conformity to custom. For a long period the customs are purely local. In England the process of developing a national or common law for the whole realm dates back to the twelfth century when the king's courts became organized, and began to weld the mass of heterogeneous local customs into a body of rules for all of the king's courts.[1] During many years, however, two kinds of special courts remained in existence side by side with the so-called king's courts, namely, the ecclesiastical courts and the courts administering what was termed the *lex mercatoria,* or custom of merchants. Inasmuch as many of the existing legal rules affecting business transac-

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[9]The extent to which codification has taken place in this country is discussed §8. *Cf,* also §325.

[10]The rules and principles of case-law, as distinguished from those formulated by a legislative body, are often spoken of as "the common law." Some writers, when under the necessity of using terms expressive of this distinction, prefer to designate case-law as "unwritten law," and law in the form of constitutions, statutes, and ordinances as "written law," but these cannot be regarded as felicitous terms. It is true that law derived from legislation has its precise scope determined by the very words of the enactment, whereas the authoritative rules and principles of case-law have to be extracted from judicial decisions by the exercise of legal reasoning; nevertheless, since judicial opinions are written and contained in the law reports, it is somewhat misleading to designate case-law as "unwritten law."

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[1]On the continent, where the state did not succeed in reshaping the administration of justice until centuries after royal officials had done so in England, there was no national law until the end of the eighteenth century.

tions have their origin in the ancient law merchant it is fitting to give a brief account of this system and of its final absorption into the common law.[2]

The law merchant was an independent body of customs, laws, and usages governing the business transactions of the cosmopolitan traders of the Middle Ages. During this period the body of commercial usages was practically uniform throughout the entire European commercial world; in other words, the merchants had what was essentially a body of international law governing their activities. The disputes of merchants with respect to their commercial transactions were not settled in the ordinary courts but in special courts whose judges were selected from the commercial community, and whose procedure was noted for its speed and untechnical character.[3] After the beginning of the seventeenth century when the king's courts began to give effect to the rules of the law merchant, the special merchants' courts dwindled into insignificance and gradually died out. For a period of approximately one hundred and fifty years the common-law tribunals dealt with the rules of the law merchant as special customs, leaving the question as to the existence of any custom to the jury without any instructions in point of law. During the latter half of the eighteenth century, however, these usages of merchants were assimilated into the common-law system as an integral part of the general law. The credit for completing this process of

[2]For an account of the law merchant and its history, see Chapter I of Scrutton, *The Elements of Mercantile Law.*

[3]At the present time special commercial courts are in successful operation both in France and in Germany. England has had a so-called Commercial Court since 1895 for litigation "arising out of the ordinary transactions of merchants and traders." This is not a distinct court, but merely a section of the King's Bench Division of the High Court of Justice.

For an account of these foreign courts as well as of certain phases of foreign law which are of interest to Americans having business dealings abroad, see a report on *Commercial Laws of England, Scotland, Germany, and France,* issued in 1915 by the Department of Commerce (Special Agents Series, No. 17).

A much fuller treatment of the commercial law of not only these, but also of several other countries, is contained in a monumental undertaking, *The Commercial Laws of the World.* The publication of the American edition was stopped by the war after the appearance of twenty volumes of the thirty-five originally planned.

absorption is largely due to Lord Mansfield (Chief Justice of the King's Bench, 1756-1788).

To be distinguished from the rules of the law merchant are those particular usages and customs of trade or business which are binding upon all traders *inter se*, and in fact upon every one who may reasonably be regarded as having made his bargain with a tacit assumption of such usages. The existence of a custom of this type is always an issue of fact which must be proved on each occasion, whereas the rules and legal doctrines of the law merchant are now in the fullest sense part of the ordinary law of the land.

The law merchant is the origin of most of our law relating to negotiable instruments, and much of our law on such subjects as partnerships, insurance, and sales of personal property. That the law merchant was not made fixed and stereotyped by its incorporation into the common law was expressly recognized in a celebrated modern case.[4] As a matter of fact, however, it is a comparatively rare occurrence at the present day for a new mercantile usage to receive from the courts the stamp of law.[5]

§4. *Equity's Contribution to the Common-Law System.*—In early times the administration of the law was not altogether free from abuses of the grossest kind. The king's officers were sometimes corrupt or partial, and for a considerable period the king's courts stood in awe of unscrupulous and powerful nobles. In extreme cases the poor subject had to seek redress of his wrongs by petition to the king, who, in theory, was the ultimate fountain of justice. Originally, these petitions were heard by the sovereign himself; later, however, they were referred to the king's council. The foremost figure in this body was the chancellor. This official served as secretary to the king, and the keeper of his seal. The early chancellors were mostly ecclesiatics, and have commonly been spoken of as "keepers of the king's conscience." It was therefore an entirely natural development that after the middle of the four-

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[4] *Goodwin v. Robarts* (1875), L. R. 10 Ex. 337, printed below, §317; *cf.* also the sections immediately following.

[5] On these trade customs *cf.* §§202-225, *infra.*

teenth century, all "matters of grace" were addressed directly to the chancellor, and in no long time this practice led to the establishment of a new tribunal in England which received the name of Court of Chancery.

By gradual stages there grew up a jurisdiction in chancery to grant relief in situations where the application to particular cases of rigid and general legal rules resulted in hardship or injustice. The rules applied by chancery in the exercise of this jurisdiction became known as "equity," whereas those administered by the previously established courts were designated as "common law."[1]

The circumstances under which the system of equity was evolved enabled it to become an instrumentality of the first importance for the improvement of law. Inasmuch as their jurisdiction was avowedly supplementary and discretionary in character, the chancellors could be more responsive than the older common-law courts to the requirements of the gradual enlightenment of the public conscience. "The rules of Courts of Equity are not like the rules of the Common Law, supposed to have been established from time immemorial. It is perfectly well known that they have been established from time to time—altered, improved, and refined from time to time. In many cases we know the names of the Chancellors who invented them. No doubt they were invented for the purpose of securing the better administration of justice, but still, they were invented."[2]

The peculiar nature of chancery procedure tended to confirm chancellors in their disposition to accord a dominating influence to the principles prescribed by "good conscience." The decree of a chancellor is directed primarily against a particular person and binds other persons only when they are so related to that person that "good conscience" requires that they, too, should be subject to his duties (that is, when they are donees or purchasers with notice). The decrees of equity are, to use a lawyer's phrase, decrees *in personam*. The importance of this characteristic of equity's process has been em-

[1]This is a third sense in which the phrase "common law" is used. For the other two meanings, see §1 and §2, n. 10.

[2]Jessel, M. R., *Re Hallett's Estate* (1879), L. R. 13 Ch. Div. 696, 710.

phasized by a distinguished scholar in these words: "The difference between the judgment at law and the decree in equity goes to the root of the whole matter. The law regards chiefly the right of the plaintiff, and gives judgment that he recover the land, debt, or damages, because they are his. Equity lays the stress upon the duty of the defendant, and decrees that he do or refrain from doing a certain thing because he ought to act or forbear. It is because of this emphasis upon the defendant's duty that equity is so much more ethical than law."[3]

The numerous ways in which equity became an important liberalizing and reforming agency in our legal system need not now be considered: its doctrines can be better understood by considering them in connection with the various topics which form the subject-matter of this book. The two generalizations which naturally emerge from the present discussion are that equity was superior to the common law not only as regards the more ethical character of its doctrines but also as regards its methods of administration. The common-law courts were without the remedy of injunction to prevent the commission of a tort, and had no machinery to compel the specific performance of a contract. The power of courts of equity, on the other hand, to compel personal obedience, enabled them to invent these, and other much needed remedies. It is hardly necessary to add, however, that the exercise of these exclusively equitable remedies can be successfully invoked only in those situations in which there is no adequate remedy at law.

§5. *The Alliance of Law and Equity in Modern Times.*—The period of equity's most vigorous expansion was one of open antagonism and jealousy between the courts of common law and the courts of equity. The older tribunals especially resented the interference of the chancellor whenever the latter would enjoin a successful litigant from taking advantage of his judgment at law. All hope of successful opposition to this prac-

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[3]See an article by James Barr Ames, 22 Harv. L. Rev. 97, at pages 105, 106; to be found also in Ames' *Lectures on Legal History*, at p. 444.

tice vanished after James I in 1616 issued his famous decree in favor of chancery.[1]

As equity matured, the creative energy of its judges noticeably slackened. At one time there was a measure of truth in the reproach that the principles of natural justice which equity administered were both vague and capricious, but the introduction of the practice of reporting the decisions of the Court of Chancery, and of appointing lawyers instead of ecclesiastics to the chancellorship encouraged the habit of adhering to precedent. The process of transforming equity into a system of settled principles reached its completion during the first quarter of the nineteenth century under Lord Eldon. This very eminent chancellor once remarked: "I cannot agree that the doctrines of this Court are to be changed with every succeeding judge. Nothing would inflict on me greater pain in quitting this place, than the recollection that I had done anything to justify the reproach that the equity of this Court varies like the Chancellor's foot."[2] After Lord Eldon's time it was accepted as a matter of course that the decisions of a court of equity did not reflect the personal views of the judge as to what "good conscience" would require, but were merely applications of the principles underlying former decisions of equity.

About the same time that equity was being crystallized into a fixed system with a body of rules nearly as rigid as those of the common law, not a few of its doctrines were being appropriated by the common-law courts and administered through the common-law forms of action.[3] Thenceforth many voices kept raising the question whether the historical distinction between common law and equity was logical, necessary, or really desirable. In England the agitation for simplification and reform in the administration of the law finally led to the passage

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[1]See Jenks, *Short History of English Law*, pp. 165-166.

[2]*Gee v. Pritchard* (1818), 2 Swanston, 414.

[3]This extension of the scope of common-law remedies was especially encouraged by Lord Mansfield, who became Chief Justice of the King's Bench in 1756.

The limitations of such a development are discussed in an article by Sydney G. Fisher, on *The Administration of Equity Through Common Law Forms*, 1 Law. Q. Rev. 455; Select Essays in Anglo-American *Legal History*, Vol. II, 810.

of the Judicature Acts of 1873-1875. This legislation abolished the old common-law courts and also the court of chancery, and established a new court—the High Court of Justice, administering the rules of both law and equity. There is a general provision that where there is a "conflict or variance" between the rules of law and those of equity the latter are to prevail. In this country the enactment of legislation abolishing chancery as a separate court and creating a court "having general jurisdiction in law and equity" began more than twenty-five years before the passage of the English Judicature Acts. As early as 1846, the State of New York took the lead in this matter. Two years later there was enacted in that state a Code of Procedure which consolidated legal and equitable modes of procedure into but one form of action for the enforcement of both legal and equitable rights. The New York legislation effecting a so-called fusion of law and equity has been copied by a majority of the states. In the Federal courts and in Florida, Illinois, Maine, Maryland, Massachusetts, Michigan, New Hampshire, Pennsylvania, Rhode Island, Texas, Virginia, and West Virginia, common law and equity are administered by only one set of judges, but the procedure is kept distinct. In Alabama, Delaware, Mississippi, New Jersey, Tennessee, and Vermont, common law and equity are not merely retained as distinct systems but are still administered by distinct courts. Even in the code states where law and equity are said to be "merged," rights originally enforceable in courts of chancery retain their original characteristics.

§6. *The Stationary and the Progressive Elements in Judicial Decisions.*—Our system of law, as we have seen, is one which "slowly broadens down from precedent to precedent." The most far-reaching judicial decisions are, therefore, representative of the past rather than of the present. It is nevertheless indisputable that the current output of judicial decisions does not flow wholly through the channels made by past decisions. The way in which case-law develops has been described by a learned jurist as follows: "In form its growth is logical. The official theory is that each new decision follows syllogistically from existing precedents. . . . On the other hand, in sub-

stance the growth of the law is legislative. And this in a deeper sense than that what the courts declare to have always been the law is in fact new. It is legislative in its grounds. The very considerations which judges most rarely mention, and always with an apology, are the secret root from which the law draws all the juices of life. I mean, of course, considerations of what is expedient for the community concerned. Every important principle which is developed by litigation is in fact and at bottom the result of more or less definitely understood views of public policy; most generally, to be sure, under our practice and traditions, the unconscious result of instinctive preferences and inarticulate convictions, but none the less traceable to views of public policy in the last analysis."[1]

In no jurisdiction has judicial practice entirely conformed with the orthodox view that judges are "not delegated to pronounce a new law, but to maintain and expound the old one."[2] Judges are compelled to decide many cases for which no exact precedent exists. In the exercise of this function, they are at liberty to select and possibly develop those precedents which seem to them to be most nearly in point, and to some extent, therefore, judges have always attempted more or less deliberately to direct the growth of the law in such a way that legal rules would commend themselves to the prevailing opinion of that day. Nevertheless, a conservative writer has said: "We may, at any rate as regards the nineteenth century, lay it down as a rule that judge-made law has, owing to the training and age of our judges, tended at any given moment to represent the convictions of an earlier era than the ideas represented by parliamentary legislation. If a statute, as already stated, is apt to reproduce the public opinion not so much of today as of yesterday, judge-made law occasionally represents the opinion of the day before yesterday."[3]

§7. *Relation of Legal Procedure to the Growth of Substantive Law.*—For a long time the process of modifying and discarding old rules and substituting new ones in order to prevent

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[1]Holmes, *The Common Law*, pp. 35, 36.
[2]Blackstone, 1 Comm. 69.
[3]Dicey, *Law and Public Opinion in the Nineteenth Century*, p. 369.

ossification of the law was greatly embarrassed by reason of the undue rigidity which characterized "common-law procedure," that is to say, the common-law remedies for enforcing and protecting legal rights. Strange as it may seem from the modern viewpoint, the common law began with the remedy and ended with the right. Early common-law theory held that no right of action existed unless there was a recognized form of action by which it could be enforced. Inasmuch as originally the forms of action available were exceedingly rigid in character, and strictly limited in number, it often happened in the old days that a plaintiff with a real grievance had to go without relief merely because he could not bring the facts of his case under one of the established forms of action. In 1285 the famous statute of Westminister II [1] recognized the propriety of framing new writs "in like cases" analogous to those of the existing forms of action. A really liberal use of the provisions of this statute might well have enabled the common-law courts to enlarge their jurisdiction so effectively as to check the growing jurisdiction of the chancellors. Although the conservatism of the judiciary prevented this result, the statute was never actually smothered. At various times it was relied upon to originate certain new common-law remedies which were greatly needed. Notable among these new remedies was the action on the case—the great residuary remedy in that branch of the law known as torts, which according to the accepted legal classification embraces the numerous heterogeneous wrongs which give rise to actions for compensatory damages, but which are neither breaches of contract nor of trust. Some of the specialized forms of the action on the case were subsequently transformed and developed in a really remarkable way.[2] Some of the steps in this process of expanding the scope of the remedy could be taken only by boldly inventing a fiction.[3]

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[1] 13 Ed. I., c. 24.

[2] A striking example of this is the history of the action of assumpsit which has been traced by James Barr Ames in a brilliant essay in 2 Harv. L. Rev. 1-19, 53-69; to be found also in Ames' *Lectures on Legal History*, 129-166.

[3] The use of fictions was resorted to as the easiest means for extending the scope of more than one writ. The more primitive the society, the more effective this device, because fictions "satisfy the

The days during which remedial law operated as a serious hampering influence on the development of the substantive law have gradually passed away. Nevertheless, few would assert that common-law procedure even after a long process of evolution ever acquired the quality of reasonable simplicity and flexibility. And it became notorious that equity practice, instead of improving with the years, became increasingly technical, dilatory, and expensive. Agitation for the reform of legal procedure culminated in radical and widespread legislation beginning about the middle of the nineteenth century. In most jurisdictions, forms of action are now abolished, while in some others a few simple forms are substituted for the old ones.[4]

Not a few of the artificial doctrines which originated out of the old forms of action still remain to be eliminated from the substantive law. "Forms of action are dead, but their ghosts still haunt the precincts of the law. In their life they were powers of evil, and even in death they have not wholly ceased from troubling. In earlier days they filled the law with formalism and fiction, confusion and complexity, and though most of the mischief which they did has been buried with them, some portion of it remains inherent in the law of the present day. . . We are still called upon to observe distinctions and

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desire for improvement, which is not quite wanting, at the same time that they do not offend the superstitious disrelish for change which is always present." Sir Henry Maine, *Ancient Law* (5th ed.), 26. But the device still finds its use in advanced communities where the law for any reason gets into an intolerably rigid state.

[4]It is not necessary, however, to be a conspicuous optimist to believe in the improvability of the statutory systems of procedure, particularly those which are more or less modelled on the New York legislation. The New York "Code of Procedure" aimed "to simplify and abridge the practice, pleadings, and proceedings of the courts" by abolishing the involved system of pleading inherited from England and substituting for it a simple statement of the facts constituting the cause of action or the defense thereto. Unfortunately, however, the codes of New York and other states have been so overlaid with a multitude of amendments made almost annually by the legislatures that the administration of the law is still clogged by intricate and vexing questions of procedure.

The procedure in equity suits in the federal courts was simplified with much success in 1912 by the Supreme Court of the United States acting under the authority of Congress. In Massachusetts and several other states procedural questions have been largely left to the regulation of the courts themselves, and this method of improving legal procedure seems to promise the best results in most cases.

subtleties that have no substance or justification in them, but are nothing more than an evil inheritance from the days when forms of action and of pleading held the legal system in their clutches.''[5]

While it is not appropriate in a book for non-professional readers to explain the technicalities of the law of procedure, it is fitting to refer to the fact that many business men feel that the existing remedies afforded by the courts are not sufficiently certain, speedy, and inexpensive to meet the needs of the business community. It is significant that business men are more and more leaving the settlement of their commercial disputes to non-judicial tribunals, such as the ''Committees of Arbitration'' which have recently been established by many trade and commercial organizations.[6]

§8. *Legislation as a Source of New Law.*—Law is developed by three agencies according to a classification made by Sir Henry Maine.[1] Named in the order of their origin, these agencies are fictions, equity, legislation. With reference to their present relative importance the same authority has declared that ''the capital fact in the mechanism of modern states is the energy of legislatures.''[2]

It is not uncommon to hear expressions of regret over the fact that the courts have not displayed a larger measure of initiative and skill in adapting old principles of law to the affairs of our complex and rapidly changing modern life. Thus President Wilson once said: ''Have we got to a time when the only way to change law is by statute? The changing of law by statute seems to me like mending a garment with a patch;

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[5]Professor John W. Salmond, 21 L. Quart. Rev. 43.

[6]A description of procedure at law will be found in §§246, 247 *infra*. For a note on arbitration see §195 *infra*.

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[1]See the famous chapter on Legal Fictions in his *Ancient Law*.

[2]*Early History of Institutions*, p. 398.

It has been stated on good authority that an investigation covering the four years ending December 1, 1913, showed that Congress and the state legislatures had in that short period passed more than 62,000 laws. There is of course in addition a huge body of subsidiary laws consisting of the rules and regulations of a considerable number of local bureaus and commissions such as boards of health, building boards, and similar governing bodies and municipal ordinances.

whereas law should grow by the life that is in it, not by the life that is outside of it. . . . I should hate to think that the law did not derive its impulse from looking forward rather than from looking backward, or, rather, that it did not derive its instruction from looking about and seeing what the circumstances of men actually are and what the impulses of justice necessarily are.''[3]

Although there are various shades of opinion with respect to the proper attitude of the judiciary towards proposed changes in the body of our case-law, it may well be questioned whether even the most progressively disposed courts are at the present time warranted in undertaking radically to modify the traditional elements of the law to meet the ever-new needs of the changing, advancing life of today. The duty of courts to abide by former decisions is by no means the only factor to be considered. An even more important consideration is the havoc which a judge-made change of law necessarily produces. An innovation made by the courts, unlike a legislative enactment, is retroactive in its effect. It introduces an element into the law which is all but controlling in subsequent litigation, even though the parties to the transaction entered into it at a time when justifiable reliance could still be placed on the old rule. Moreover, there is an entire lack of adequate judicial machinery for finding out the real facts in our current social and economic life. A knowledge of these facts is absolutely essential to intelligent leadership in the solution of the many new problems which are constantly arising from the new relationships and activities of a society which is changing with unprecedented rapidity. Finally, it may be suggested that it is probably more in harmony with our dominant political philosophy that the legislatures rather than a professional judiciary should be the agency for making any material modifications of the traditional law.[4]

Much of the legislation of the present time has to do with

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[3]Remarks at the annual convention of the American Bar Association on October 20, 1914.

[4]For a discussion of these and related matters, see an article by Professor Pound on *Common Law and Legislation*, 21 Harv. L. Rev. 383.

the new problems that have resulted from the evolution of modern capitalistic industry. It deals with such questions as the relation of employers and employees, the right of association and combination, and the regulation of professions and of business. The argument for carefully considered legislation of this kind has been stated by a broad-visioned statesman as follows:

"Instead of the give and take of free individual contract, the tremendous power of organization has combined great aggregations of capital in enormous industrial establishments, working through vast agencies of commerce and employing great masses of men in movements of production and transportation and trade; so great is the mass that each individual concerned in them is quite helpless by himself. The relations between the employer and the employed, between the owners of aggregated capital and the units of organized labor, between the small producer, the small trader, the consumer, and the great transporting and manufacturing and distributing agencies, all present new questions for the solution of which the old reliance upon the free action of individual wills appears quite inadequate. And in many directions the intervention of that organized control which we call government seems necessary to produce the same result of justice and right conduct which obtained through the attrition of individuals before the new conditions arose."[5]

The general aim of contemporary economic legislation is to protect the very substantial interest which the general public has today in certain situations which at an earlier period were the almost exclusively personal affair of the individuals immediately concerned. In order adequately to safeguard the public interest it has been thought necessary to establish numerous administrative boards and commissions, both state and national. Thus it has come about during the present generation that some of the rules and principles of conduct which are enforced by the authority of the state are enforced outside the courts. This is true of an ever-increasing body of laws to regulate railroads, public utilities, banks, insurance companies, the relations of

[5]Ex-Senator Root of New York in an address before the New York State Bar Association, January 19, 1912. *Cf.* §§352, 353, *infra.*

labor with employers, and even the activities of interstate business enterprises with reference to their competitors.[6]

The aim of the so-called social legislation of our time is to make it possible for every individual to live a full all-around human life so far as legal regulation can accomplish this result. Its program stands for the widest attainable extension of opportunity, welfare, and contentment for the masses. This type of legislation is predicated upon the conviction that in certain situations of our modern industrial society the traditional individualistic basis of right and liability embodied in the existing law of contract and property impedes the progress of social reform. To give the claims of "social justice" the sanction of law it is deemed necessary to make sweeping innovations in the rules protecting private property and encouraging free bargaining. Hence, the enactment of legislation dealing not only with factory conditions, workmen's compensation, the prevention of child labor, shorter hours for labor, but also in the last decade legislation for old age and mothers' pensions, and minimum wages.[7]

The efficacy of governmental interference with individual liberty of action in order to improve society through law, and the extent to which present-day collective interference is based upon well-reasoned general principles and an adequate knowledge of facts, are of course, controversial subjects which fall outside the scope of this book. The present trend towards increased government control over the business affairs of individuals is likely to continue whatever fate be in store for the movement which invokes the aid of the law in conserving the social interest in the individual life. The nationalizing of private industries due to the exigencies of war has doubtless resulted in reconciling the voting majorities to a program of increased government control of industrial activity during the period of reconstruction, and probably more or less permanently.

Legislative changes in the substance of the "private law," by which is meant law which regulates the relations of individuals (and corporations) to each other, have been confined

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[6] *Cf.* §35 *infra.*
[7] *Cf.* §§349ff. *infra.*

for the most part to the enactment of economic and social legislation of the kinds described. There is also of course, legislation which aims not to change the law relating to a given subject, but to reduce it into orderly and systematic form. In Georgia, California, Idaho, Montana, North Dakota, South Dakota, and Oklahoma, the entire substantive law has been enacted in the form of a code. In all other states, except Louisiana, which since 1808 has had a civil code based largely on the Code of Napoleon, codification of the substantive law has been only partial and piecemeal in character, and the great bulk of everyday dealings between man and man is still governed by case-law.

Certain uniform acts recommended by the Commission on Uniform State Laws have been enacted in a varying number of states.[8] On the whole, however, the legislation enacted in the various states has been notoriously lacking in uniformity. It is, therefore, impracticable, in a book of this kind, to embrace within its scope a treatment of American statute law.[9]

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[8]Discussed §14 *infra*. See also Appendix I.

[9]In Appendix II. will be found an enumeration of some of the more important kinds of legislation enacted by Congress, the several state legislatures, and the various minor local governing bodies.

Those interested in the study of comparative legislation will sometimes find useful material in the publication of the Bureaus of Legislative Information which now exist in a number of states, and also in the special legislative reports issued by the American Association for Labor Legislation, and similar organizations.

Such persons are also recommended to keep in touch with the current output of the United States Government Printing Office. Many of its publications deal more or less fully with contemporary state legislation; for instance, the Bureau of Labor Statistics issues each year a bulletin on labor legislation of the preceding year.

There are a number of legal directories, published annually, which contain synopses of the laws of each of the states with respect to a variety of matters which are of interest to business men. Reference may also be made to the annually published corporation manuals.

Stimson's *American Statute Law* contains a digest and comparison of the statutes of the various states upon subjects of public general interest. It should not be overlooked, however, that the legislatures have been busily engaged in the production of much new statute law since the appearance of this compilation in 1886-92.

As an aid in the study of comparative state legislation the State Library of New York during a ten-year period published a *Year Book of Legislation*. Unfortunately no publication of this series has appeared since 1907. The American Bar Association prints in its annual volume a report of a Committee on Noteworthy Changes in Statute Law, both state and federal.

§9. *The Power of Courts in the Interpretation of Statutes.* —It is the plain duty of the courts to give effect to a valid statutory enactment whenever it is applicable to the decision of a case. But the task of application must wait upon that of interpretation, for of course the words of a statute do not interpret themselves. To entrust the functions of application and interpretations to two distinct groups of men is obviously impracticable, and hence the interpretation of statutes is everywhere (in spite of the attempts of several codifiers to reserve this privilege for themselves or their commissioners), one of the recognized functions of the judiciary.

The prime importance of the function of interpretation is a matter which has always been well understood by discerning minds. Two hundred years ago it was roundly affirmed by an ecclesiastic that "whoever hath an absolute authority to interpret any written or spoken laws, it is he who is truly the Law-Giver to all intents and purposes, and not the person who first wrote or spoke them."[1] It should not be supposed, of course, that there is no science of the interpretation of statutes, that the process of interpretation is unembarrassed with established legal rules. Such rules unquestionably exist. It is true, nevertheless, that the process of interpretation by the courts is inherently one source, though to be sure a subordinate one, of law. This is because the function of interpretation is not confined, as is sometimes unthinkingly assumed, to declaring the meaning of those terms in a statute which may be susceptible of diverse meanings. The immense amount of legislation which is crudely drawn may soon force the establishment of legislative reference bureaus or legislative drafting commissions as a way of escape out of a situation which is rapidly becoming intolerable. But the utmost care in the drafting of statutes cannot be expected altogether to do away with another and really more important kind of interpretation. The necessity for this arises from the fact that no foresight can foresee everything. To provide in advance for

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[1]Bishop Hoadley in a sermon preached before the King, 1717 (15th ed.), 12 quoted by Gray, *The Nature and Sources of the Law*, sec. 276.

every one of the contingencies that may arise in the course of the practical operation of a statute is frequently a task beyond human wisdom. The famous Statute of Frauds is a striking illustration of a statute which was supposed to be expressed in specific terms but which was nevertheless found to contain unanticipated gaps which could be filled up only by a process of so-called interpretation. Moreover, cases arise in which the facts will not fall wholly within one principle or provision of the statute, but partly within one and partly within another. An even greater power over legislation is exercised by the courts when they are called upon to define the scope of a statute which was designedly expressed in rather vague and general terms. The controlling influence of the judicial power over legislation of this type will be impressed upon anyone who will make a study in chronological order of those decisions of the United States Supreme Court which turn on the interpretation of the Sherman Anti-Trust Act.

§10. *The Power of Courts in the Construction of Constitutional Provisions.*—In this country, the Constitution of the United States and those of the several states are all written constitutions. In all of them it is provided by the sovereign people that the power of the legislative body shall be subject to certain specified restrictions. From this it results that the question whether any given statute is or is not law depends upon whether it was enacted in pursuance of the delegated authority of the legislative body. The final determination of this question is not a function of the legislative body but of the judiciary.[1]

When it is borne in mind how difficult it is to make changes in our constitutions, and how frequently constitutional provisions are expressed in very general terms, it will be readily understood why our constitutions as they now stand, particularly the Federal Constitution, are in no small measure the work of the judiciary.

It is inappropriate in this book even to enumerate the multi-

[1]This doctrine has the support of a long line of decisions, both in the federal and the state courts. All of these decisions go back, however, to the epoch-making opinion of Chief-Justice Marshall, in *Marbury v. Madison* (1803), 1 Cranch, 137.

farious provisions of the Federal and State Constitutions, much less to discuss the rules of constitutional construction which are followed by the courts. In order, however, to emphasize the far-reaching significance and delicacy of the process of interpreting the fundamental law it may be well to set forth one of the better-known provisions in the Federal Constitution, and to point out the nature of the problems involved in the construction of this provision. It is only in this way that one can realize the supreme importance of having as judges of our courts of last resort, especially the federal courts, men whose knowledge of the law is supplemented by a large store of practical wisdom and is guided by principles of sound statesmanship.

Consider, for example, the clause in the Fourteenth Amendment which declares, "Nor shall any state deprive any person of life, liberty, or property, without due process of law." In recent years no other clause in the Constitution, with the possible exception of the provision giving Congress the power to regulate interstate commerce, figures so largely in the constitutional decisions of the federal courts. Of the multitude of constitutional decisions involving a construction of this clause the ones which have evoked the most lively interest on the part of the laity have been those dealing with a state statute which has attempted to deprive an individual of a measure of his "liberty of contract." In every case of this kind the court is confronted with the question, Is the legislative command, and that alone, "due process of law"? [2]

The conventional method of stating the answer to this problem is to declare that the particular enactment was, or was not, a proper exercise of the power inherent in sovereignty,—the state's "police power," as it is called.[3] There is universal agree-

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[2]For enlightening analysis of this question, see an article by Albert M. Kales in 26 Yale Law J., 519-549, and see also an article by Judge Charles M. Hough in 32 Harv. Law Rev. 218-233.

[3]The police power is "that power which inheres in the legislature to make, ordain, and establish all manner of reasonable regulations and laws, whereby to preserve the business and order of society, and the safety of its members, and to prescribe the mode and manner in which everyone may so use and enjoy that which is his own, as not to preclude a corresponding use and enjoyment of their own by others." Cooley, *Principle of Const. Law* (3d ed.), 338.

ment upon the proposition that liberty of contract is subject to police power limitations. The accepted doctrine has been expressed by Mr. Justice Holmes in the following words: "There is no absolute freedom to do as one wills or to contract as one chooses. The guaranty of liberty does not withdraw from legislative supervision that wide department of activity which consists of the making of contracts, or deny to government the power to provide restrictive safeguards. Liberty implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interests of the community."[4]

How, then, does a court proceed to interpret "due process" when it becomes necessary for it to define the rights of the individual which are protected by the Amendment as against the rights of a state to exercise its police power? It should be borne in mind that the amendment contains no specific definitions of the prohibited encroachments by the state, and further, that the limits of a state's power of regulation in the interest of the health, morals, safety, order, and well-being of society are, because of the inherent nature of the power, incapable of exact definition. The euphonious generalities so characteristic of judicial opinions in this class of cases help but little in the decision of new cases. It is the gradually accumulated mass of actual decisions to which one must look for dependable guidance in drawing the line between constitutional and unconstitutional state legislation. This process of inclusion and exclusion has been explained by Mr. Justice Holmes as follows: "All rights tend to declare themselves absolute to their logical extreme. Yet all in fact are limited by the neighborhood of principles of policy which are other than those on which the particular right is founded, and which become strong enough to hold their own when a certain point is reached. The limits set to property by other public interests present themselves as a branch of what is called the police power of the state. The boundary at which the conflicting interests balance cannot be determined by any general formula in advance, but points in the line, or helping to establish it, are fixed by decisions that this or that concrete case falls on the nearer or farther side."[5]

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[4]*Chicago, B. & Q. R. Co. v. McQuire* (1911), 219 U. S. 549, 567.
[5]*Hudson County Water Co. v. McCarter* (1908), 209 U. S. 349, 355.

Such being the issues involved the courts are wisely wary of committing themselves to any definite test with respect to the validity of the exercise of the police power of a state. What then, is the actual situation in constitutional decisions of this type? It has been summarized in these words by Mr. Justice Holmes: "General propositions do not decide concrete cases. The decision will depend on a judgment or intuition more subtle than any articulate major premise."[6] An analysis of any one of the accepted generalizations will substantiate this statement. Consider, for instance, the statement that whether or not the state police power has been properly exercised depends "upon the circumstances of each case and the character of the regulation, whether arbitrary or reasonable and whether really designed to accomplish a legitimate public purpose."[7] To begin with, this generalization manifestly leaves undefined what constitutes a "legitimate public purpose." Courts have proceeded cautiously in this respect, and with good reason, for a static conception of "legitimate public purpose" would doubtless work mischief in the long run. Hence, although it is well understood that the public health, the public safety, and the public morals are interests which may be protected by the police power, it is still unsettled to what extent a state may intervene in the interests of the social and economic welfare of the community. It was once said by Mr. Justice Holmes in a widely quoted opinion that "it may be said in a general way that the police power extends to all the great public needs. *Camfield v. U. S.* (1897) 167 U. S. 518. It may be put forth in aid of what is sanctioned by usage, or held by the prevailing morality or strong and preponderant opinion to be greatly and immediately necessary to the public welfare."[8] However, it is by no means true that all judges would be ready to hold that the scope of the right to legislate for "the public welfare" is as broad as this statement would indicate.

Even when the ostensible purpose of a statute is one embraced within the scope of the police power, the question of the statute's

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[6] *Lochner v. New York* (1905), 198 U. S. 45, 76.

[7] *Railroad Co. v. Drainage Commissioners* (1906), 200 U. S. 561, 592, per Harlan, J.

[8] *Noble State Bank v. Haskell* (1911), 219 U. S. 104, 111.

constitutionality involves a further point according to the usual mode of solving the problem, namely, whether or not there is any reasonable basis for legislative belief that the statute is "really designed to accomplish a legitimate public purpose." In deciding this question courts very properly feel themselves obliged to bear in mind that it lies very largely within the discretion of the legislature and not of the judiciary to determine what measures are reasonably adapted for the accomplishment of a "public purpose." There is, moreover, an established and wholesome doctrine that in order for an act to be declared unconstitutional, the case must be so plain that no reasonable doubt can be said to exist. Nevertheless, it is too much to expect unvarying unanimity on the part of judges on the question whether the actual provisions of a given statutory enactment can fairly be regarded as reasonably conceived to effectuate its avowed purpose as a protective police regulation. This question is essentially one of fact, and is obviously allied to the further question of the degree of "arbitrariness" in the legislative regulation or prohibition of contract. Judges are not omniscient and their occasional refusal to sustain the constitutionality of reform social legislation is more apt to arise from an inadequate presentation to them of the industrial facts and conditions upon which the police power is predicated than from mental attitudes or predilections based on environment and education.[9] Differences of opinion on the part of judges should, therefore, be expected from time to time, and in the border-line cases caustic comment over "five to four" decisions is clearly unjustified.

Two comparatively recent cases in which labor legislation by a state has been declared unconstitutional by the United States Supreme Court will serve to give point to the preceding dis-

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[9]It is not difficult, of course, to find a number of cases in which the courts have refused to take into consideration pertinent social and economic facts collected by investigating committees and legislative commissions. Perhaps the most conspicuous case of this sort is the now discountenanced decision of *Ives v. South Buffalo Ry. Co.* (1911), 201 N. Y. 271, in which the Court of Appeals of New York held a workmen's compensation act to violate the Fourteenth Amendment and the similar provisions of the Constitution of the State of New York.

cussion.[10] One of these cases involved the constitutionality of a New York statute which made it a misdemeanor to require or permit an employee in a bakery or confectionery establishment to work more than sixty hours a week or more than ten hours a day, unless for the purpose of making a shorter working day on the last day of the week. The New York Court of Appeals, by a bare majority, held the statute to be constitutional as a proper exercise of the police power.[11] The United States Supreme Court, however, by a bare majority, declared the statute to be unconstitutional.[12] In both tribunals, the majority and minority judges, not only expressed fundamentally differing views with regards to the so-called "liberty of contract,"[13] but also disagreed on the issues of fact as to whether a fair-minded man might regard the baker's occupation under modern industrial conditions as peculiarly unhealthful, and as to whether the character of the New York legislation was reasonably calculated to protect the health of employees in this industry.

The other illustrative case is one which dealt with the constitutionality of a statute supposedly advantageous to the cause of labor unionism. A Kansas statute, as contrued and applied by the highest state court, provided that an employer or his agent should be subject to criminal punishment in case he prescribed as a condition upon which a workman could secure employment under him (or could remain in the employment, when it was terminable at will), that the employee enter into an agreement not to become a member of any labor organization while so employed. The Supreme Court of Kansas sustained this statute but the Supreme Court of the United States, by a divided court,

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[10]For a collection of material on the law and the courts in relation to the development of what is generally known as the labor movement, see Final Report and Testimony Submitted to Congress by the Commission on Industrial Relations created by the Act of August 23, 1913, volume 11, pp. 10451-10928.

[11]*People v. Lochner* (1904), 177 N. Y. 145.

[12]*Lochner v. State of New York* (1905), 198 U. S. 45. Harlan, White, Day, and Holmes, JJ. dissented.

[13]The later decision of *Bunting v. State of Oregon*, (1916) 243 U. S. 426, in which the Supreme Court of the United States (Justices White, Van Devanter, and McReynolds dissenting), upheld the constitutionality of an Oregon statute regulating hours of labor, indicates a changed attitude of the court with regard to legislation of this type.

held it to be contrary to the Fourteenth Amendment.[14] Mr. Justice Pitney, in speaking for the majority, took the following position: ''In that portion of the Kansas statute which is now under consideration—that is to say, aside from coercion, etc.—there is no object or purpose expressed or implied, that is claimed to have reference to health, safety, morals, or public welfare, beyond the supposed desirability of leveling inequalities of fortune by depriving one who has property of some part of what is characterized as his 'financial independence.' In short, an interference with the normal exercise of personal liberty and property rights is the primary object of the statute, and not an incident to the advancement of the general welfare.'' The dissenting judges, on the other hand, held that the legislation in question was justified because under present-day conditions a prohibition of economic coercion against labor unions tends to promote industrial peace, and consequently the maintenance of the safety and security of the community. In the words of Mr. Justice Day, who delivered one of the dissenting opinions: ''It would be difficult to select any subject more intimately related to good order and the security of the community than that under consideration—whether one takes the view that labor organizations are advantageous or the reverse. It is certainly as much a matter for legislative consideration and action as contracts in restraint of trade.''

To prevent misapprehension on the part of those who dissent from the majority view in one or both of the cases under discussion, it should not be left unsaid that a careful examination of all decisions by the Supreme Court of the United States will reveal relatively few cases in which that Court has not maintained a liberal attitude with respect to the police power of the states.[15]

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[14]*Coppage v. Kansas* (1915), 236 U. S. 1. Day, Holmes, and Hughes, JJ. dissented.

[15]See the articles by Charles Warren, *The Progressiveness of the United States Supreme Court*, 13 Col. L. Rev., 294, and *A Bulwark to the State Police Power—The United States Supreme Court*, 13 Col. Rev. 667.

CHAPTER II

SCOPE AND CLASSIFICATION OF BUSINESS LAW

§11. *The Field of Business Law.*—In many countries the law governing business activities forms a separate and distinct branch of jurisprudence, and is administered in special mercantile courts. Where the Anglo-American law prevails it is not so. In our legal system no sharp distinction exists between traders and non-traders, and we have no independent body of rules peculiar to business.[1] With us, therefore, the scope of business law, or commercial law, cannot be outlined with the precision which is characteristic of scientific legal classification. These terms, nevertheless, have a well-understood meaning in our common speech. They are currently used to denote the aggregate of those rules of the general law that have frequent and direct application to the conduct of business. Business law is, therefore, a concept whose boundaries are somewhat shadowy, but this is of course true of all general words which have no technical meaning, and have the sanction of usage merely because they are convenient collective terms of reference.

§12. *Analysis of the Activities of Business Men.*—Every well-considered attempt to select and to organize for purposes of practical presentation those rules of law which govern the more familiar business relations and business transactions, must be grounded upon a clear analytical knowledge of business operations.

The subject matter of business may be divided roughly into the external relations and the internal affairs of an establishment. Both sets of relations are largely governed by contractual principles, but in the interpretation of the contracts involved, there is a considerable amount of implication based on the ordi-

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[1] *Cf.* §§18, 19 *infra.*

nary usages of business, or on positive law. To understand either the contractual portion or that portion which shades off from it by degrees into the absolute requirements of the law from without, it is necessary to keep very close to the facts of business.

§13. *Classification of Business Law.*—The external relations concretely take the form of buying and selling. The expressions must be understood in a very broad sense, so as to include the purchase and sale of services as well as of things. Again, room must be left in the definition of our terms for the most complicated contractual relations that link up one business with another to the very point of organizing them together as parts of a business unit. In one sense, the distinction between such a close organization and the most ordinary touch-and-go exchange of commodities is a difference of degree rather than of kind, and the law of external business relations may, therefore, be looked upon as a means toward that larger organization which makes a unit of all society. The first three parts of the book will treat of these external relations under the following heads: I. Engaging in Business. II. The Law of Contracts, with special reference to the relation of buyer and seller. III. The Enforcement of Legal Obligations, with special reference to the law of debtor and creditor.

The first part of the work deals with a part of the law which was very largely neglected during the last century because the law, in response to the current political and economic theories of *laissez-faire,* had reached a point where it had not only ceased to regulate business, but where it had questioned its own power to do so. The reaction of the last generation in an opposite direction has been very violent at times and the older concepts of the law had to be very much strained to meet the new conditions. It is, therefore, quite necessary for the business man of today to understand the legal consequences of the mere act of engaging in business, even before a single contract is made.

The second division of the subject, that of contracts, is one that reached its culmination in the nineteenth century in Anglo-American law. The law of sales, as a particular branch of the

subject, has been codified both in England and America. Our difficulty here will not be, as in the first part, to construct tentative principles or to organize scattered materials, but rather to warn against the illusion of rounded phrases and plausible conceptions that make it difficult at times to realize that we are dealing with life and not mere logic.

In the third part, we bring together from remote parts of the law the principles that affect credit. Credit is a business concept, rather than a legal one. Unlike contracts, therefore, it cannot be found well worked out in the law books. Yet, unlike the subject of engaging in business, it is by no means made up of constituent parts that can be called novel. In fact, for the purpose of safeguarding credit, business men have devised adaptations of some of the oldest concepts in the law, and the difficulties of the subject grow largely out of the fact that there was no thought of serving modern business when these instrumentalities were fashioned.

The fourth part of the book deals with the internal relations that constitute business organization. The law of master and servant, the law of principal and agent, the law of partnerships and corporations, have all been thoroughly worked out in excellent legal treatises. To some extent they have necessarily been compared, or rather contrasted, from a legal point of view. Our particular task, however, is to contrast them systematically, with reference to their business ends. After all, they serve but a single set of functions, and for historical reasons, which we must consider, they serve them quite unevenly, or at least differently. In working out any business problem involving organization, one of the factors, at least, is a knowledge of the limitations placed by law upon the various types of these instrumentalities, from which a choice must usually be made for the particular problem in hand.

§14. *Uniform State Laws Relating to Business.*—Since business is today increasingly interstate in character—it has been estimated that nine-tenths of the volume of commerce in the United States is interstate commerce—it is vitally desirable that the law governing business should be uniform throughout the

country. Of course the law makes appropriate provisions whereby to determine which rule of law is to govern in dealing with every phase of a transaction which has taken place or been given effect partly in one place and partly in another or between citizens of different states. But the complicated nature of this branch of law (generally known as Conflict of Laws), is illustrated in the following supposition in Gray's *Nature and Sources of the Law* (§282):

> Suppose a contract is made for the carriage of goods. The offer is made by a letter written in Paris and is accepted in Madrid; the goods are to be carried from Lisbon, in a Liverpool ship, to Naples; one party is domiciled in Stockholm and the other in St. Petersburg; a suit is brought on the contract in Berlin; judgment is obtained there; and an action is brought on the judgment in New York. In what way, and to what extent [are] the Laws of France, Spain, Portugal, England, Italy, Sweden, Russia, Germany, and New York, respectively, to be considered?

It must be remembered in this connection that the several states of the United States are to each other "foreign jurisdictions." The possibilities of federal legislation directed to the end of removing unnecessary divergencies are rather narrowly limited by the Constitution of the United States. Moreover, it is obviously out of the question to expect co-operative action by courts of last resort in the several states with a view to achieving uniformity in the case-law of the several states. Consequently, with respect to most matters, eradication of diversity in legal rules can be secured only by the voluntary action of the various state legislatures. The practical difficulties in the way of securing co-operative effort by a large number of state legislatures cannot always be overcome; but as regards business law there is at least this encouragement, that "the more any department of law lies within the domain of economic interest, the more do the rules that belong to it become the same in all countries, for in the domain of economic interest Reason and Science have full play."[1]

Various associations of business men, in their efforts to

[1] James Bryce, *Studies in History and Jurisprudence*, p. 123.

secure the adoption of laws which are of especial interest to their membership, have thereby also become allied, to a greater or less degree, with the broad movement in favor of standardizing our commercial law.[2] Hitherto, however, the chief support of the movement for the promotion of uniformity of legislation in the different states has come from the American Bar Association, which was largely instrumental in the creation of the National Conference of Commissioners on Uniform State Laws.[3] The Commissioners are appointed by the various states, territories, and federal districts (usually three from each of these jurisdictions). Annual conferences have been held ever since the first meeting in 1892. Up to the present time this body has approved and recommended for adoption eighteen Uniform Acts. The most important of these Acts from the standpoint of business are the Negotiable Instruments Act, the Sales Act, the Warehouse Receipts Act, the Bills of Lading Act, the Stock Transfer Act, the Partnership Act, and the Workmen's Compensation Act. Tentative drafts of acts relating to various other subjects of importance are still in the stage of revision and discussion by the Commissioners. The task of securing the adoption of Uniform Acts by the various state legislatures has been attended with varying degrees of success. It is noteworthy, however, that the work of the commissioners in fields other than commercial law, for example divorce, probate, wills, desertion, child labor, domestic and foreign acknowledgments, and the like, has been decidedly less successful than their codification of commercial law. The reason for this difference is an interesting subject for speculation: It may be that there is not the same need of uniformity in the other fields as there is in commerce; or, though the ultimate need may exist there, too, it may be that commerce with us, as in ancient Rome,

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[2]Among such associations are the American Bankers' Association, National Association of Credit Men, American Warehousemen's Association, and a number of national associations of manufacturers engaged in various industries.

Other organizations which have interested themselves in behalf of uniform state legislation are the National Civic Federation and the Chamber of Commerce of the United States of America.

[3]The proceedings of the annual conference of these commissioners appear in annual publications. See also the annual Reports of the American Bar Association.

is destined to serve as a liberalizing force to free our law from provincialism (so Dean Pound suggests); or, finally, though the need and the desire may both coexist, the foundations for uniformity may not have been laid in these other fields as they have in commercial practice. At all events, up to 1920 the Uniform Negotiable Instruments Act had been adopted by all the jurisdictions of the United States except Georgia, Porto Rico, and Texas; on the other hand, none of the other Acts, with the exception of the Sales Act, the Bills of Lading Act, and the Warehouse Receipts Act, has been passed in more than twenty jurisdictions.[4]

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[4]For a table showing jurisdictions which have adopted the Uniform Acts, see Appendix I.

European conferences have been held from time to time with a view to securing greater uniformity in the laws of the various commercial nations on the subject of bills of exchange and checks. A uniform laws on bills of exchange was drafted at the Second Hague Conference in 1912. See Report of United States delegates to Second Hague Conference, S. Doc. 162, 63d Cong., 1st sess.

The International High Commission, a Pan-American organization to promote commerce and trade relations between the United States and the Latin-American republics, aims so far as is practicable to secure the adoption of uniform laws and uniform practice respecting trade and commercial transactions between these countries.

For an interesting discussion of the beginnings of the International Assimilation of Commercial Law, see the Article by Georg Cohn, translated in *Progress of Continental Law in the Nineteenth Century* (Continental Legal History Series), pp. 347-395, brought down to 1918 by Professor Lorenzen.

CHAPTER III

CASE MATERIAL

§15. *Suggestions to the Student for the Use of Case Material.*—The use of cases as a means for presenting the law, though in reality one of the oldest methods of teaching English and American law, dates in American Law Schools for practical purposes from the publication of the first case book—a collection of cases on Contracts—by C. C. Langdell, Dean of the Harvard Law School (1870). Since that event case books have made remarkable headway in the teaching of law in America and the principle upon which they are based has spread to other departments of university instruction, notably medicine, history (the source books), and economics. For at least twenty-five years, however, this system met with much opposition, and a very considerable polemical literature on the best methods of teaching and studying law came into existence as a result.

Most of this literature, of course, was concerned specifically with the needs of professional law students under the peculiar problems growing out of the condition of Anglo-American law at the end of the nineteenth century. Among these conditions there was a growing diversity of the legal systems of the several states, a lack of the systematic literature of the law such as had grown up in some of the older legal systems, a general attitude towards the law among lawyers that may roughly be described as a combination of the theories of the historical school of jurisprudence and the eighteenth century philosophy of "natural law," both of which taught that the law was something to be found rather than something to be made. An eminent European scholar, Professor Josef Redlich, visited America in 1911 for the purpose of making a study of the method of teaching law in vogue here. His conclusions (published by the Carnegie

Foundation for the Advancement of Teaching), were practically an endorsement of the case method, not absolutely and for all times and conditions and purposes, but as a means of meeting the special problems to which it was being applied in the law school curriculum.

At the same time there are many features of the use of cases for the purpose of teaching law that recommend the system even to the business student. In the first place the method is closely connected with a fundamental doctrine of the common law—the doctrine of *stare decisis*.[1]

Again, the use of cases recommends itself for reasons that transcend the peculiar history of the common law of England and America. It is somewhat analogous to the laboratory method of mastering the physical sciences. Besides, it presents concrete illustrations as an introduction to the abstractions of the law. And above all, it seems to work very well. For the business student there is another consideration that makes the study of cases useful. The concrete facts of cases in business law are business facts. The situations are business situations which have many interesting aspects beside the legal aspect. It is extremely important to train one's self, not only in the analysis that isolates the legal proposition from the facts of a case (as must be done by all law students), but also in the synthetic work of fitting the legal proposition to the facts of business so that they may be an aid in the solution of business problems.

To accomplish the first task, the analytical task, it is necessary to bear in mind certain principles that will serve as keys to discovery of the doctrine of the case. These have been summarized by Professor Wambaugh in his book on *The Study of Cases* (2d edition, 1894, p. 29), as follows:

"*The Four Keys to the Discovery of the Doctrine of a Case:*

I. The court must decide the very case before it;
II. The court must decide the case in accordance with a general doctrine;
III. The words used by the court are not necessarily the doctrine of the case;

[1]See §2, *supra.*

IV. The doctrine of the case must be a doctrine that is in the mind of the court.

The Marks Essential to the Doctrine of a Case:

Hence the doctrine of a case is a general proposition of law from which, taken in connection with the circumstances of the case the decision logically follows, and upon which, whether expressed in the opinion or not, the court bases its decision.

In addition to the doctrine of the case, there may be in the opinion of the court an argument showing how the court reached its doctrine, whether on historical or logical grounds, and in addition *obiter dicta* or words going beyond the needs of a particular case, and dealing with related matters. These dicta and arguments are frequently very valuable although they are not the law of the case, and care must be taken in citing a case as an authority to distinguish between those points upon which the court was compelled to decide and on which it presumably had the benefit of the arguments of counsel and all the other points on which the court volunteers information."

When this first task is done, the facts from which the doctrine of the case has been threshed must not be winnowed away like so much chaff. These facts show how business is done, and it is a pertinent question in every case why business is done in that particular way. To what extent has the law been a conditioning factor—to what extent has it served as a check upon the development of methods favored by other factors in the business world? It is important to ascertain just exactly what the parties in the case have been attempting to accomplish as a matter of business, whether they chose the best legal apparatus, and in general what the effect would have been if they had used other means for the accomplishment of the same business ends.

The student is advised to form the habit of referring to a good law dictionary for definitions of the technical terms, explanations of the abbreviations, maxims and the like. Bouvier's Law Dictionary, or Black's or even the larger dictionaries of the English language will be found capable of clearing up many

of the mysteries which at first make cases seem highly technical and even uninviting to the beginner.[2]

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[2]William M. Lile, *et al.*, *Brief-Making and the Use of Law Books*, 3d ed. St. Paul, 1914.

Frederick C. Hicks, *Aids to the Study and Use of Law Books*, New York, 1913.

Townes, John C., *Law Books and How to Use Them* (In *Library of American Law and Practice*, 1912, vol. 1, pp. 118-188.)

John B. Kaiser, *Law, Legislation, and Municipal Reference Libraries*, Boston, 1914.

Several of the law-book publishing houses distribute catalogues that purport to be fairly complete bibliographies of current law.

Legal Periodical Literature will be found indexed in two volumes by Jones (1888, 1899), continued by Chipman, one volume (1907), and in the Index to Legal Periodicals, published quarterly (cumulative volume, annually), in conjunction with the Law Library Journal.

PART I

ENGAGING IN BUSINESS

CHAPTER IV

THE LEGAL STATUS OR CONDITION OF THE BUSINESS MAN

§16. *BUTCHERS' UNION COMPANY v. CRESCENT CITY COMPANY.*

Supreme Court of the United States. 1883. [111 *U. S.* 746.]

FIELD, J.: . . . As in our intercourse with our fellow-men certain principles of morality are assumed to exist, without which society would be impossible, so certain inherent rights lie at the foundation of all governmental action, and upon a recognition of them alone can free institutions be maintained. These inherent rights have never been more happily expressed than in the Declaration of Independence, that new evangel of liberty to the people: "We hold these truths to be self-evident" —that is, so plain that their truth is recognized upon their mere statement—"that all men are endowed"—not by edicts of emperors, or decrees of Parliament, or acts of Congress, but "by their Creator with certain inalienable rights"—that is, rights which cannot be bartered away, or given away, or taken away except in punishment of crime—"and that among these are life, liberty, and the pursuit of happiness, and to secure these"—not grant them, but secure them—"governments are instituted among men, deriving their just powers from the consent of the governed." Among these inalienable rights, as proclaimed in that great document, is the right of men to pursue their happiness, by which is meant the right to pursue any lawful business or vocation, in any manner not inconsistent with the equal rights of others, which may increase their prosperity or develop their faculties, so as to give to them their highest enjoyment. The common business and callings of life, the ordinary trades and pursuits, which are innocuous in themselves, and have been followed in all communities from time immemorial, must, therefore, be free in this country to all alike upon the same conditions. The right to pursue them, without let or hindrance,

except that which is applied to all persons of the same age, sex, and condition, is a distinguishing privilege of citizens of the United States, and an essential element of that freedom which they claim as their birthright. It has been well said that, "The property which every man has in his own labor, as it is the original foundation of all other property, so it is the most sacred and inviolable. The patrimony of the poor man lies in the strength and dexterity of his own hands, and to hinder his employing this strength and dexterity in what manner he thinks proper, without injury to his neighbor, is a plain violation of this most sacred property. It is a manifest encroachment upon the just liberty both of the workman and of those who might be disposed to employ him. As it hinders the one from working at what he thinks proper, so it hinders the others from employing whom they think proper."—Adam Smith's *Wealth of Nations*, Bk. I, Chap. 10. . . . The first section of the [14th] amendment is stripped of all its protective force, if its application be limited to the privileges and immunities of citizens of the United States as distinguished from citizens of the States, and thus its prohibition be extended only to the abridgement or impairment of such rights, as the right to come to the seat of government, . . . which are specified in the opinion in the *Slaughter-House Cases,* 16 Wall. 36, as the special rights of such citizens. If thus limited, nothing was accomplished by adopting it. The states could not previously have interfered with these privileges and immunities, or any other privileges and immunities which citizens enjoyed under the Constitution and laws of the United States. . . . Whilst, therefore, I fully concur in the decision of the court that it was entirely competent for the state to annul the monopoly features of the original Act, incorporating the plaintiff, I am of opinion that the Act, in creating the monopoly in an ordinary employment and business, was to that extent against common right and void.

§17. *The "Right" of Engaging in Business.*—The language used here by Mr. Justice Field is typical of the thought of many nineteenth century lawyers in America with reference to "natural" or super-legal rights. Are there any such rights sufficiently clear and ascertainable in their nature to claim recognition along with positive law, and if so, is the right to engage in business one of them? Here an attempt is made to interpret the Constitution of the United States as creating or recognizing such a right.

§18 *WITHERLEY v. SARSFIELD.*

Court of King's Bench, 1689. [1 *Shower* 125; *Carthew* 82.]

[In defense to an action on a bill of exchange it was said that the defendant was a "gentleman" and not a "merchant." On the other side it was argued as follows:]

Shower [arguing]:—Besides, the matter of this plea is ill, for it is repugnant in itself; for he admits himself to have drawn the bill, and yet traverses that he never was *a merchant,* whereas the bare negotiating of a bill of exchange makes him a merchant for that purpose; the very act of taking up monies in a foreign country, and undertaking for the repayment here by bill of exchange is such an act of merchandize as you will take notice of. Monies now are become merchandize, and some men's business is wholly in its exchange. The rates and profits of exchange are now certainly known: a man may be dealer or trader in one sort or kind, that is not so generally. Though he be not a trader so as to be capable of being a bankrupt, yet he may be a trader to oblige himself by his own act. The parliament in the last statute of bankrupts made a *quaere* whether a man that had a stock in a company was a trader, and therefore by express provision did except them. So that a little matter will make a man a trader. Besides, the inconveniency will be great both at home and abroad, and work a manifest wrong. If a bill be payable to him he has the advantage of it, though a gentleman, *pari ratione* he ought to be bound. If a traveller's bill drawn beyond sea shall not enforce a payment upon a protest our English gentry must suffer in their credit, when by their laws they are answerable, though not as merchants, and by ours must not. The necessity and usefulness of transferring money easily by bills of exchange commands all the encouragement imaginable; and therefore I prayed a reversal.

Hoil *e contra.* By their own showing he must be *a merchant* else not within the custom . . .

HOLT, Chief Justice: . . . This drawing a bill must surely make him *a trader* for that purpose, for we all have bills directed to us, or payable to us, which must be all avoidable, if the negotiating a bill will not oblige, &c.

§19. *"Ad hoc, a trader."* Prior to the seventeenth century, the merchants in rural England were mostly foreigners. To engage in trade in England, they required a more or less special license involving many limitations, but generally giving the great boon of the right to be tried in a speedy, untechnical mer-

chants' court in accordance with the universal custom of merchants. The merchants themselves were the authorities on their law and the procedure was more like a complaint to a market-master than like a resort to a court.[1] This practice explains the absence from our law books, prior to 1600, of mercantile cases. At the same time, it illuminates the foreign origin of the Law Merchant and incidentally the tendency it manifests to be uniform throughout the civilized world. In the seventeenth century a contest was being waged between the ordinary King's courts and these special courts, one result of which was to give the ordinary courts complete jurisdiction in the growing field of business. A corollary of this movement is illustrated in the above case: Not only is there one set of courts for all parts of the law, but one system of law for all types of people. The Law Merchant thus becomes a part of the ordinary law of the land.[2]

At the same time this case shows a breaking down of the older theories of a distinction in the eyes of the law between traders and non-traders. The older law, as illustrated in the anonymous case of 21 Henry 6 (see below §49), imposed peculiar duties upon those engaged "commonly" or habitually in trades or professions. In the seventeen-hundreds and early eighteen-hundreds, this feature of the law had almost, if not entirely, disappeared excepting in the case of common carriers, common innkeepers and possibly members of certain professions. There is a marked tendency to revert to the older conception by means of licensing laws. But even in the absence of such laws, the flexible expressions, "due care," "due diligence," and the like, have created a distinction between the duty of one engaged in a trade or profession and that of the non-trader under similar conditions. In the following case, for example, would it have made any difference had the defendant not been a professional dressmaker?

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[1]See the lively record of the court of the Fair of St. Ives in the thirteenth century, 2 Selden Society Publications, 130. On such courts in general see Gross, *The Court of Piepowder*, 20 Quarterly Journal of Economics 231; *Select Cases Concerning the Law Merchant*, 1270-1638; 23 Selden Society Publications (1908).

[2]Isaacs, *The Merchant and His Law*, 23 Journal of Pol. Econ. 529.

§20 *LINCOLN v. GAY.*

Supreme Judicial Court of Massachusetts, 1895.
[164 *Mass.* 537.]

[Goods were left with a dressmaker to be made up. The dress was made up on the wrong side.]

MORTON, J.: If the dress was delivered to the defendant by the plaintiff without any instructions, the defendant, being a bailee for hire, was held to that degree of skill and care in the particular occupation in which she was engaged, which was that of a dressmaker, which would enable her to do the work intrusted to her in a reasonable and proper manner. *Jackson v. Adams,* 9 Mass. 484. Story, *Bailments,* Sec. 431, and cases cited. Her understanding that it was a proper way to make the dress up wrong side out would be immaterial, therefore, if in the exercise of a proper degree of skill and care the dress ought not to have been made up in that way.

So much of the instruction requested as related to the matter of estoppel was also clearly erroneous. It made the plaintiff's knowledge that the dress was being made up wrong side out the sole test. But in order to justify the jury in finding an estoppel, it was necessary that there should be evidence tending to show that the defendant was induced by the plaintiff's conduct to do something different from what she would otherwise have done, and that the plaintiff knew or had reasonable cause to know that the defendant would so act. *Tracy v. Lincoln,* 145 Mass. 357. *Stiff v. Ashton,* 155 Mass. 130. The instructions requested omitted this element. We doubt also whether the evidence would have warranted a finding that there was an estoppel. The jury have negatived the claim of the defendant that the plaintiff gave her instructions to make the dress up wrong side out. The defendant had begun to make the dress before the plaintiff saw the garment, and it does not appear that she was induced to make it up wrong side out in consequence of anything that the plaintiff said or did, or omitted to say or do.

The remaining instruction was also rightly refused. The defendant offered to put the interlining in, and the plaintiff thereupon said that if she would put the interlining in and fix the collar she would accept the suit. It does not appear that this proposition was accepted by the defendant before it was withdrawn by the plaintiff.

We discover no error in the instructions as given, or in the refusals to rule as requested.

Exceptions overruled.

§21. *From 3 Blackstone's Commentaries* 164.—"An advocate or attorney that betray the cause of their client, or, being retained, neglect to appear at the trial, by which the cause miscarries, are liable to an action on the case, for a reparation to their injured client. There is also in law always an implied contract with a common innkeeper, to secure his guest's goods in his inn; with a common farrier, that he shoes a horse well, without laming him; with a common tailor, or other workman, that he performs his business in a workmanlike manner; in which if they fail, an action on the case lies to recover damages for such breach of their general undertaking. But if I employ a person to transact any of these concerns, whose common profession and business it is not, the law implies no such *general* undertaking; but, in order to charge him with damages, a *special* agreement is required. Also, if an innkeeper, or other victualer, hangs out a sign and opens his house for travelers, it is an implied engagement to entertain all persons who travel that way; and upon this universal *assumpsit* an action on the case will lie against him for damages, if he without good reason refuses to admit a traveler."

§22 *ALSOP v. TRUST CO.*

Kentucky Court of Appeals, 1897. [100 *Ky.* 375.]

BURNAM, J.: In a commercial partnership the extent of a partner's power to bind the firm is a question of law, while in the non-commercial firm the power of one partner to bind his co-partner is a question of fact, and the burden of proof to establish the facts as to the validity of contracts so executed by one member of such partnership rests with the party claiming to hold the firm liable. . . .

§23. *Rhode Island Laws* (1909-10), Ch. 538. Sec. 1.—No person or persons shall hereafter carry on or conduct or transact business in this state under any assumed name, or under any designation, name, or style, corporate or otherwise, other than the real name or names of the individual or individuals conducting or transacting such business, unless such person or persons shall file, in the office of the town or city clerk in the town or city in which such person or persons conduct or transact, or intend to conduct or transact, such business, a certificate

setting forth the name under which such business is, or is to be, conducted or transacted, and the true or real full name or names, both Christian and surname, of the person or persons conducting or transacting the same, with the postoffice address or addresses of said person or persons. Said certificate shall be executed and duly acknowledged before some person authorized to administer oaths by the person or persons so conducting or intending to conduct such business.[1]

§24. *Sale in Bulk Statutes.*—Statutes have in recent years been passed in many states, having for their object the protection of creditors against the possibility that a retailer, after contracting debts, may sell out secretly and disappear with the proceeds. Such legislation applies only to business men who are retailers.

§25. *Uniform Sales Act,* Sec. 15 (2):—Where the goods are bought by description from a seller who deals in goods of that description (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be of merchantable quality.

Before the enactment of the Sales Act in over twenty American jurisdictions, it was held in the majority of the states that no such warranty existed where the seller was merely a dealer. Williston on *Sales,* Sec. 233.

§26. *The Liability of the Manufacturer of a Defective Automobile to a Sub-Vendee. Note in* 29 *Harv. L. Rev.* 866.—"The much discussed question of the liability of a manufacturer of an article which, because of his negligence, is defective, to a remote vendee who is injured as a result of the defect, has been passed on by the New York Court of Appeals in a way which will undoubtedly settle the question in that state. In a recent case, the manufacturer of an automobile was held liable to a sub-vendee for an injury resulting from a defective wheel which negligent inspection had allowed to become a part of the

[1]Statutes having the same object are in force in about half the states. In some of these jurisdictions a violation of the statute is punishable as a misdemeanor, while in other jurisdictions an offender is deprived of the right to enforce his contracts in the state courts.

machine. *McPherson v. Buick Motor Co.* (1916), 54 N. Y. L. J. 2339. [217 N. Y. 382; 111 N. E. Rep. 1050.]

It is well settled that the manufacturer of an article impliedly warrants its merchantability and general fitness for use. This is a comparatively modern rule, but is merely an extension of the stringent liability early imposed on the seller of food. The rule is now extended to all articles, and an automobile is clearly not an exception. But since a warranty does not run with the goods, it can only be taken advantage of by the immediate vendee.

On the other hand, it would seem clear on principle that when the manufacturer is negligent (but only then), he should be liable to anyone within the zone of danger from his negligence and injured as a proximate result of it. However, the courts have generally denied the existence of such liability to anyone with whom the manufacturer did not directly contract. This is put on the ground that there is no duty to anyone but the immediate vendee. But apart from any contract relations, a manufacturer certainly ought to owe a duty to anyone who is likely to be injured by his negligence in making the article; and who can be more likely to suffer injury than the sub-vendee who is to use it? The denial of his right, therefore, can probably be best explained by reference to theories of legal causation that are now considered antiquated. Of course the manufacturer cannot be held liable unless his act is wrongful; he is justified in selling a defective article if he gives proper warning to his immediate vendee, and he could not then be held liable for an injury to a sub-vendee. But when no warning has been given, as must always be the case when the negligence has been unwitting, there has been a wrongful act to found the liability. The liability should then extend to any injured person whose contact with the goods could have been foreseen at the time the defendant made the sale. The other rule, combined with the American doctrine that in a sale of specific goods a dealer makes no implied warranty against latent defects, brings about the result that often the injured sub-vendee can get no redress at all. He cannot sue the manufac-

turer, and he cannot sue the dealer because the latter is not negligent. Such a result is most unfortunate.

The realization of courts that this was so, resulted in two far-reaching exceptions to the rule. One is where the manufacturer fraudulently conceals known defects. The other is where the article is "intrinsically dangerous." In either of these exceptions it is hard to find any duty to the injured subvendee if it does not exist in the ordinary case. The latter exception is very elastic. Its development has been especially interesting in New York. The first case recognizing the exception applied it to a poisonous drug improperly labeled. But a little later the principle was held not to apply to a flywheel nor to a boiler. In later years, however, the New York courts have carried this exception to its extreme and the following articles have been held intrinsically dangerous: A scaffold, a derrick rope, an elevator, a siphon bottle, and a steam coffee urn. Indeed, two other courts have informed us that a cake of soap is such an intrinsically dangerous article. When we see a so-called exception carried to such extremes, it clearly shows that the rule itself is recognized as wrong and is as good as abrogated.

Fortunately, however, the court in the principal case does not attempt to justify its result (as indeed it might without serious inconsistency have done), on a further application of the exception of intrinsically dangerous articles. The decision is avowedly based on ordinary principles of tort liability. The result reached must be deemed alike sound in principle and desirable in policy."[1]

§27. *Competition and Good Will.*—The value of good will and other intangible assets connected with a "going concern" is a well-established business fact. The law, however, has been slow to recognize its existence. Although intangible assets are indirectly protected by law in various ways, it can hardly be said that even at this time there is any definite recognition of

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[1][But see the opinion in the Court of Appeals affirming the decision (217 N. Y. 382). And compare with this opinion, *Cadillac Motor Car Co. v. Johnson* (1915), 221 Fed. 801.—*Edrs.*]

intangible assets as such by our legal system. "Good will," which in legal parlance is used to include a great deal more than in business parlance, was first forced upon the attention of courts of equity in connection with subsidiary contracts that business men persisted in making on the sale of a well-established business or route or clientele, to the effect that the seller would not compete with the purchaser. For a long time the validity of such contracts or stipulations in contracts was seriously questioned. It was supposed by some, for example, to interfere with the public policy which demanded the encouragement of competition. Then mechanical rules were propounded whereby proper interferences with competition could be distinguished from improper ones, and the cases discussed such questions as whether the time of the agreement or the space contemplated by it was sufficiently limited. These mechanical theories led to such absurdities as agreements not to engage in a certain business anywhere in the United States, with the exception of one state, and for a time such agreements were upheld. Today, the tendency is strongly away from these mechanical tests and it is broadly laid down that where the agreement not to compete is simply a means of effecting the transfer of good will, the agreement will stand. Where its purpose is clearly to transcend the effectuation of such transfer, the agreement falls.[1] Still courts seem to insist that good will cannot be sold by itself, apart from tangible assets in which it is somehow supposed to inhere. An exception is found in the case of attempts by physicians and other professional men to sell their "practice," but it may be seriously questioned whether anything at all is looked upon as being sold in such a case, the agreement to introduce the successor and not to compete with him being all that the law has to regard.

Independently of this development of a recognition of good will through an extension of the law of contract, there has come about, by a development of the concept of property, a tendency to recognize intangible assets as a type of property. The history of copyright reminds us how recently the law has begun

[1]For an index to these cases see *Corpus Juris* article on contracts 411ff. (13 C. J. 468).

to extend its sphere to the protection of what authors have long considered a very clear example of property.[2] Patents have a longer history, but the patent in the modern sense of a means of protecting one in the enjoyment of a reasonable profit accruing from his inventions is, as the very name indicates, based on the analogy not of ordinary property, but of special concession from the Crown given to favorites to enable them to reap advantages from monopoly. In one sense, this analogy does suggest property—property in that feudal sense in which many kinds of rights, including public offices, were and still are in England dealt with as if they were interests in land. Finally, trademarks are spoken of as a kind of property, although in reality a trademark is merely an indication of the commercial origin of goods, by means of a mark placed upon the article itself or upon its container, enclosing package or wrapper. "It is true," says Holmes, J., "that some judges, noticeably Lord Westbury, have preferred to rest the protection of trademarks on the notion of property, rather than of fraud; but it is plain, upon reading his judgments, that he means no more than that the deception, which equity will prevent, need not have been intended, as when a man ignorantly adopts a trademark already in use, and that within certain limits a trademark may be sold, which nobody denies."[3]

This statement, however, suggests a very close approximation to the law of property, for in the absence of a technical trademark, a very different set of rules applies in fixing liability for interference with one's business (see cases below, §§37, ff.).

Recently legislatures have felt constrained to take cognizance of the existence of intangible assets for the purpose of taxation, of estimating fair returns, and similar purposes. The law is now working out bases for the valuing of these intangible assets. The few cases that have involved the question up to the present seem to indicate not only a tendency to lump all

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[2]In this country patents and copyrights are dependent on the action of Congress. Pamphlets containing the law relating to patents and copyrights may be purchased from the Superintendent of Documents, Government Printing Office, Washington, D. C.

[3]*Chadwick v. Covall* (1890), 181 Mass. 190, 194.

intangible assets inaccurately as "good will," but also a skepticism about so-called scientific methods of valuation proposed by scholars who have recently given much attention to the subject.[4] Nevertheless, there is distinct and increasing recognition of the business facts of good will and other intangible assets.[5]

[4]Cf. Hatfield, *Modern Accounting*, 107-120; Dicksee and Tillyard, *Goodwill and its Treatment in Accounts;* McKay, *Valuing Industrial Properties*, 287ff.

[5]*Von Au v. Magenheimer*, 100 N. Y. Supp. 659, affirmed (1909) 196 N. Y. 510; *In the matter of Skillman*, 105 N. Y. Supp. 872 (121 App. Div. 202), affirmed (1908), 190 N. Y. 560; *In re Moore*, (1916) 97 N. Y. Misc. 238.

CHAPTER V

LIMITATIONS IMPOSED BY LAW ON THE PRIVILEGE OF TRADING.

§28. *BARTEMEYER v. IOWA.*

Supreme Court of the United States, 1874. [18 *Wall.* 129.]

[Bartemeyer was prosecuted for selling and delivering "to one Timothy Hickey one glass of intoxicating liquor called whiskey," contrary to the provisions of an Act of the Iowa Legislature.] MILLER, J. The case has been submitted to us on printed argument. That on the part of the plaintiff in error has taken a very wide range, and is largely composed of the arguments familiar to all, against the right of the states to regulate traffic in intoxicating liquors. So far as this argument deals with the mere question of regulating this traffic or even its total prohibition, as it may have been affected by anything in the Federal Constitution prior to the recent amendments of that instrument, we do not propose to enter into a discussion. Up to that time it had been considered as falling within the police regulations of the states, left to their judgment, and subject to no other limitations than such as were imposed by the State Constitution, or by the general principles supposed to limit all legislative power. It has never been seriously contended that such laws raised any question growing out of the Constitution of the United States.

But the case before us is supposed by counsel of the plaintiff in error to present a violation of the Fourteenth Amendment of the Constitution, on the ground that the Act of the Iowa Legislature is a violation of the privileges and immunities of citizens of the United States which that amendment declares shall not be abridged by the states; and that in his case it deprives him of his property without due process of law.

As regards both branches of this defence, it is to be observed that the statute of Iowa, which is complained of, was in existence long before the amendment of the Federal Constitution, which is thus invoked to render it invalid. Whatever were the privileges and immunities of Mr. Bartemeyer, as they stood

before that amendment, under the Iowa statute, they have certainly not been abridged by any action of the state legislature since that amendment became a part of the Constitution. And unless that amendment confers privileges and immunities which he did not previously possess, the argument fails. But the most liberal advocate of the rights conferred by that amendment have contended for nothing more than that the rights of the citizen previously existing, and dependent wholly on state laws for their recognition, are now placed under the protection of the Federal government, and are secured by the Federal Constitution. The weight of authority is overwhelming that no such immunity has heretofore existed as would prevent state legislatures from regulating and even prohibiting the traffic in intoxicating drinks, with a solitary exception. That exception is the case of a law operating so rigidly on property in existence at the time of its passage, absolutely prohibiting its sale, as to amount to depriving the owner of his property. A single case, that of *Wynehamer v. The People*, 13 N. Y. 486, has held that as to such property the statute would be void for that reason. But no case has held that such a law was void as violating the privileges or immunities of citizens of a state or of the United States. If, however, such a proposition is seriously urged, we think that the right to sell intoxicating liquors, so far as such a right exists, is not one of the rights growing out of citizenship of the United States, and in this regard the case falls within the principles laid down by this court in the *Slaughter-House Cases*, 16 Wallace 36.

But if it were true, and it was fairly presented to us, that the defendant was the owner of the glass of intoxicating liquor which he sold to Hickey, at the time that the State of Iowa first imposed an absolute prohibition on the sale of such liquors, then we concede that two very grave questions would arise, namely: 1. Whether this would be a statute depriving him of his property without due process of law; and secondly, whether if it were so, it would be so far a violation of the Fourteenth Amendment in that regard as would call for judicial action by this court?

Both of these questions, whenever they may be presented to us, are of an importance to require the most careful and serious consideration. They are not to be lightly treated, nor are we authorized to make any advances to meet them until we are required to do so by the duties of our position.

In the case before us, the Supreme Court of Iowa, whose judgment we are called on to review, did not consider it. They said that the record did not present it.

It is true the bill of exceptions, as it seems to us, does show that the defendant's plea was all the evidence given, but this does not remove the difficulty in our minds. The plea states that the defendant was the owner of the glass of liquor sold prior to the passage of the law under which the proceedings against him were instituted, being chapter sixty-four of the revision of 1860.

If this is to be treated as an allegation that the defendant was the owner of that glass of liquor prior to 1860, it is insufficient, because the revision of the laws of Iowa of 1860 was not an enactment of new laws, but a revision of those previously enacted; and there has been in existence in the State of Iowa, ever since the code of 1851, a law strictly prohibiting the sale of such liquors; the Act in all essential particulars under which the defendant was prosecuted, amended in some immaterial points. If it is supposed that the averment is helped by the statement that he owned the liquor before the law was passed, the answer is that this is a mere conclusion of law. He should have stated when he became the owner of the liquor, or at least have fixed a date when he did own it, and leave the court to decide when the law took effect, and apply it to his case. But the plea itself is merely argumentative, and does not state the ownership as a fact, but says he is not guilty of any offence, because of such fact.

If it be said that this manner of looking at the case is narrow and technical, we answer that the record affords to us on its face the strongest reason to believe that it has been prepared from the beginning, for the purpose of obtaining the opinion of this court on important constitutional questions without the actual existence of the facts on which such questions can alone arise.

It is absurd to suppose that the plaintiff, an ordinary retailer of drinks, could have proved, if required, that he had owned that particular glass of whiskey prior to the prohibitory liquor law of 1850 . . .

§29. *The Conception of a Free "Jus Disponendi."*—This case is interesting as an illustration of a difficulty flowing from the general acceptance of an abstract "conception" of the nature of one's rights without due regard for the purpose for which these rights are created. The conception involved here is that the *jus disponendi,* or power of selling, is necessarily implied in the right of ownership. This assumption has been the source of much law in the past, for example the doctrine of

restraints on alienation: in general it is impossible to give one complete ownership of a thing without at the same time giving him complete *jus disponendi*.[1] In connection with prohibition and similar social legislation, courts have found it necessary to recognize the possibility of limiting this *jus disponendi,* at first evasively, as in this case, but finally, frankly. The occupations listed below, as subject to licenses, are in many instances nothing but exercises of *jus disponendi* over one's own property.

§30. *Licenses.*—"As proper subjects for license or tax the following occupations or privileges have been sanctioned by the courts: Any commercial or professional business; corporate franchises and privileges; dealing in 'futures'; the keeping and use of animals; the keeping of billiard or pool tables for profit; the keeping of bowling alleys; the keeping of concert and dancing halls; keeping laundries; keeping a restaurant; mechanical trades and pursuits in general; mercantile business in general; publishing a newspaper; raising or grazing sheep; sales of goods; sales on exchanges; selling certain publications; selling foreign merchandise; selling newspapers; selling to employees or tenants; theaters and shows; vehicles and means of transportation in general; vehicles used in carrying passengers or property for hire or profit; vehicles used by merchants or manufacturers in their own private business; and vessels. And among the persons whose occupations have been declared to be properly subject to license or tax are the following: Architects; attorneys; auctioneers; bakers; banks; bill-posters; brewers; bridge companies; brokers; carriers; cigar and tobacco dealers; confectioners; corporations; dairymen; dealers in or sellers of oleomargarine; dealers in second-hand goods; dealers in trading-stamp enterprises; dentists; detectives; domestic corporations; druggists; drummers and canvassers; emigrant agents; employment agents; express companies; factors and brokers; farriers; ferries; foreign corporations; foreign insurance companies; grocery dealers; hawkers and peddlers; hospitals; ice dealers; innkeepers; insurance brokers or companies; itinerant merchants or traders; junk dealers; dealers in second-hand goods; keepers

[1] *Cf.* Gray, *Restraints on Alienation,* 2d ed. 1905.

of gaming houses; liquor dealers; livery-stable keepers; lumber dealers; manufacturers; meat dealers; merchants; milk dealers; money lenders; note-shavers; packers and carriers of oysters; patent medicine vendors; pawnbrokers; persons dealing in food; pharmacists; photographers; physicians and surgeons; pilots; pipe line companies; plumbers; produce dealers; railroad companies; sewing-machine agents; soda-water dealers; steamship companies; street railroad companies; teachers; telegraph and telephone companies; turnpike companies; vendors of lottery tickets; warehousemen; water companies; and wood dealers." (25 Cyc. 614-621.)

§31. *The Bases of Trade Licenses.*—In this list of licenses it is interesting to consider the primary purpose of each type of licensing law and also the incidental functions served by the law. Some are manifestly attempts to control dangerous or even pernicious practises; others are attempts to safeguard the public health; a few seem to be based on determining whether the public interest requires new establishments of certain types (for example, in Massachusetts before the incorporators of a trust company are allowed to begin business, they must obtain a certificate that public convenience and advantage will be promoted by the establishment of the company); some are designed to protect the public from incompetent practitioners of various kinds; still others seem to be means primarily of raising revenue.[1] For a discussion of these and other elements in licensing laws, compare the following cases.

§32 *BRAUN v. CHICAGO*

Supreme Court of Illinois, 1884 [110 *Ill.* 186.]

WALKER, J.: These cases were commenced and tried separately, before the justice of the peace and in the circuit court

[1]Whatever the purpose, the close relationship between licensing and the "police power" of the state has tended to make the modes of enforcement quite drastic. Thus, though if a corporation is improperly organized no one but the state may take advantage of the defect, if a corporation or individual proceeds to do business without a license it is generally provided that any one may take advantage of the deficiency in his dealings with the delinquent. As to what constitutes "doing business" every statute must stand on its own bottom. The decisions interpreting the expression are an instance in which the quantitative deluge defies qualitative analysis.

of Cook county; but inasmuch as the same questions are presented in both cases, they have been argued and submitted as one in this court. We shall therefore consider them together.

In the circuit court it was stipulated that Braun was engaged in selling, in the city, produce, such as butter and eggs, belonging to other persons, when sent to him for that purpose; that he sold to such persons as would buy; that he also negotiated sales of such produce for others, without having possession of the property—and for such business so conducted by him he received as compensation therefor a percentage on the gross amount of such sales. It was also stipulated that appellants Lyman & Giddings were engaged in the city in negotiating the sale of, and did sell real estate, situated in the city and elsewhere, for persons owning the same, and in bringing together persons desiring to sell and purchase, and they sold such property, and for such services they received a compensation determined by receiving a certain percentage of the price of real estate sold, or received a specific sum agreed upon between them and the seller. In both cases the parties were prosecuted for failing to obtain a license under the city ordinance, and fined before the justice of the peace, and appeals were prosecuted to the circuit court, where on trial *de novo,* they were again fined. They appealed to the Appellate Court for the First District, and in that court the judgments were affirmed, and they bring the records to this court by appeal.

Appellants insist that the city ordinance imposes a tax, and that it is not uniform, as required by the constitution, nor is it imposed by a general law; that the city charter does not authorize the adoption of an ordinance that would embrace the occupations or business in which the appellants are severally engaged, and that the legislature was powerless to enact the provision of the charter under which the ordinance was adopted. The provision of the charter referred to is clause 91, of section 62, of the general law incorporating cities, villages and towns. (Rev. Stat. 1874, p. 223.) It reads: "To tax, license, and regulate auctioneers, distillers, brewers, lumber yards, livery stables, public scales, money-changers and brokers." The ordinance adopted under this provision is this:

> "SECTION 1. It shall not be lawful for any person to exercise within this city the business of a money-changer or banker, broker or commission merchant, including that of merchandise, produce or grain broker, real estate broker and insurance broker, without a license therefor.
>
> "SEC. 2. A merchandise, produce or grain broker is

one who, for commission or other compensation is engaged in selling or negotiating the sale of goods, wares, merchandise, produce or grain belonging to others.

"SEC. 3. A real estate broker is one who, for commission or other compensation, is engaged in the selling of or negotiating sales of real estate belonging to others, or obtains or plans loans for others on real estate.

"SEC. 4. An insurance broker is one who is engaged in procuring or places insurance on buildings, vessels and other property, for others.

"SEC. 5. There shall be collected, annually, for every license granted for any banker, the sum of $100; and there shall be collected, annually, for every license granted for any broker, or commission merchant, or money-changer or broker, the sum of $25; and there shall be collected, annually, for any license granted any real estate broker, the sum of $25; and there shall be collected, annually, for every license granted for any insurance broker, the sum of $25.

"SEC. 6. That any person violating any provision of this ordinance shall be subject to a penalty of not less than $25 nor more than $100, and to the same penalty for every subsequent violation thereof."

We have so repeatedly and uniformly held that a license fee is not a tax, in the constitutional sense, that it may be regarded as settled. . . .

The ninth section[1] provides that the legislature may authorize the corporate authorities of such municipalities to levy taxes for corporate purposes. This is the source of their power to impose such taxes. But the power of the legislature and the corporate body is limited to uniformity as to persons and property within the corporate limits of such bodies. Any attempt by the legislature or the corporate authorities to depart from such uniformity as to persons or property is prohibited, and such an effort would be void. The tenth section is a limitation on the power of the legislature to impose taxes on municipal corporations, or the persons or property thereof, for corporate purposes, but it may require taxes, uniform as to persons or property therein, to be imposed for the payment of corporate debts. Thus it is seen municipal taxes are specifically provided for by these sections. It is manifest that such taxes do not depend upon, nor are they controlled by, the previous sections of that article.

[1]Of the Constitution of Illinois.

If these fees, as contended, are taxes, do they conform to the requirement of the ninth and tenth sections of that article? They are manifestly uniform as to all persons of the same class within the limits of the city. The provisions of these sections are similar to the same provisions in the constitution of 1848, and under that instrument it was held that a tax or license fee was only required to be uniform as to the class enumerated within the corporate limits. (See *East St. Louis v. Wehrung*, 46 Ill. 392, and the same case of the January term, 1868, unreported.) The provisions in each constitution being the same, they will admit of but one construction. Nor do we see any reason for departing from the construction then given to these provisions. So it is seen that whether these licenses be regarded as fees or taxes, they are fully justified by the constitution, nor do they violate any of its provisions. There is no limitation on the legislative power to invest such municipalities with the power to tax for corporate purposes, but they shall be uniform as to persons and property within the corporate limits. If such power has been conferred, and properly exercised, then, if a tax, as claimed, it must be sustained.

It is, however, urged, that the 91st clause of section 62 of the city charter is repugnant to the latter clause of section 1, of article 9, of the constitution. If this is a tax, it in no sense depends on that section for its validity. As we have seen, this tax is dependent alone on the 9th and 10th sections of that article, and can not be controlled by the 1st and 2d sections because they refer to other and entirely different taxes, levied for other than city purposes. It is true that this clause of section 62 does not require uniformity, but it does not attempt to dispense with it, and the constitution does require it, and the ordinance conforms to the requirement, and that satisfies the constitution.

If this is a tax, then there can be no question that the General Assembly had the power to authorize its imposition. Judge Cooley, from the adjudged cases, states the general doctrine to be: "The power to impose taxes is one so unlimited in force, and so searching in extent, that the courts scarcely venture to declare that it is subject to any restriction whatever, except such as restrains the authority which exercises it. It reaches every trade or occupation; to every object of industry, use and enjoyment; to every species of possession; and it imposes a burden which, in case of failure to discharge it, may be followed by seizure and sale or confiscation of property. No attribute of sovereignty is more pervading, and at no point does the power of government affect more constantly and intimately all the

relations of life, than through this power.'' (Cooley's *Const. Lim.* 479.) This statement of the doctrine must, of course, be understood as qualified by constitutional limitations imposed by the people when exercising their sovereign powers. As there is no provision of the fundamental law forbidding the imposition of this fee or tax, there can be no question that the legislature had power to authorize its imposition.

It is further insisted that the 91st clause of section 62 of the city charter does not confer power on the city to demand a license fee, in these cases, for the privilege of pursuing the various occupations of brokers. It is claimed that these appellants are not brokers—that Braun is a commission merchant, and Lyman & Giddings are real estate agents, and neither calling is embraced in that clause of the charter, and not in fact being brokers, they were not required to procure licenses to exercise their callings. Lexicographers of high authority have defined the term ''broker'' to be one who is engaged for others in negotiating contracts relative to property with the custody of which they have no concern, and this is the precise technical meaning of the term. A factor is one who sells property of others when he has its possession. Here, Braun negotiated sales of property of which he never had possession, which brings him within the definition, and Lyman & Giddings only sold property of others of which they had no possession. This brings them within that clause of the charter, and the power of the city to demand a license fee, and to impose a penalty for not procuring a license before commencing and transacting their business.

It is also insisted that if this is a police regulation, it can not be applied to any but immoral vocations, or such as are injurious to the well-being of society. The term, ''police power of the state,'' is used in different senses. In its broadest and most unlimited sense it embraces all laws or regulations for the well-being or government of the people. In its most limited sense it is used to express the power of preservation of the health or safety of the people by depriving persons of liberty, or to destroy private property, in despite of constitutional limitations, in great and pressing emergencies, to prevent the spread of contagious diseases, or other great calamities to the people or their property. To accomplish such purposes men are deprived of liberty and property without due process of law, because to resort to the ordinary processes of the law would be too slow to avert the impending calamity. But appellants claim this is a tax, and if so, then the power is referable to the legislative power to raise or authorize the raising of

revenue for general or local governments. The Federal government, for almost a quarter of a century, has imposed such fees or taxes on various business or callings, for revenue purposes, without the power being questioned. The act of Congress prohibits persons raising or producing tobacco for sale from selling it at retail, or to any person not having a license to purchase such property. Nor can the cultivator manufacture the raw material produced by his own labor without paying a heavy tax, and the manufacturers of it and particular kinds of medicines have been heavily taxed on such articles. Even matches, which enter as largely into the daily consumption of the whole people as any other article, except food, have been subject to a heavy tax. None of these things is supposed to be pernicious to the public, and yet we are aware of no question having been made and sustained as to the constitutionality of the law imposing the fee or taxes, and unless restrained by constitutional limitation the states are as fully invested with power to raise revenue for state and local purposes as in Congress to provide revenue for Federal purposes.

Nor is the objection well taken that no business can be regulated, or burthens imposed on its pursuit, unless there be power to suppress the business. In the case of *Wiggins Ferry Co. v. East St. Louis*, 102 Ill. 560, it was held the legislature had power to authorize the city to regulate the ferry, and impose a license fee for each boat used by the company, notwithstanding the franchises the company were exercising were granted by charter from the legislature. Yet no one will claim that the legislature could repeal the charter or impair its franchise, or authorize the city to do so. This case was affirmed in the Federal Supreme Court. Until a comparatively recent date our legislature required all merchants of every kind to pay for and procure a license to vend their goods, wares and merchandise, under a penalty. Nor are we aware that the power was ever questioned. And similar laws have been in force in the various states of the Union, from their organization until a recent date, if not till the present time. In the case of *Howland v. Chicago*, 108 Ill. 496, it was held that the legislature had power to authorize the city to require a keeper of a livery stable to procure a license for the purpose, under a penalty for failing to do so. Such an occupation is a natural right, as legitimate as is that of either of these appellants. We have no question of the legislative power to authorize the imposition of these license fees, and the penalties for not complying with the ordinance.

Thus we have seen that whether this be called a license fee

or a tax, it is fully authorized by the constitution; nor does the charter or ordinance conflict with any of its provisions.

The judgments of the Appellate Court in these cases are affirmed.

§33. *The Power to License and the Power to Destroy.*—It is frequently said that the power to tax is the power to destroy. The licensing power has likewise been used as an indirect means of practically prohibiting certain classes of business. The power of the state to impose a prohibitive tax on the use of trading stamps, redeemable in merchandise, has frequently been questioned in the state courts. The Supreme Court of the United States has finally decided that such statutes are constitutional as a proper exercise of the police power in *Rast v. Van Deman & Lewis Co.,* (1916) 240 U. S. 342.

§34. *Same. Note in* 29 *Harv. L. Rev.* 779 *on Rast v. Van Deman & Lewis Co.*—"The great weight of authority has hitherto held such statutes unconstitutional. *People v. Gillson,* 109 N. Y. 389; *Ex parte Drexel,* 147 Cal. 763, 82 Pac. 429. See 2 L. R. A., n. s. 588, note. The cases went on the ground that since there was no element of chance in the trading stamp business, it did not partake of the nature of gambling, but was a legitimate form of advertising, and as such could not be prohibited. See Freund, *Police Power,* sec. 293. But it is at least arguable that such schemes, by tempting the ignorant with the hope of getting something for nothing, lure them to improvidence and extravagant expenditure. Futhermore, unlike ordinary advertising, the trading-stamp system serves no useful purpose. See Freund, *Police Power,* p. 279. It thrusts an additional and unnecessary cost on distribution which must ultimately be borne by the entire public, and under our competitive system it cannot be successfully resisted by individuals. And it would be a perversion of the Fourteenth Amendment to say that it prohibits the remedy of community action in these otherwise incurable diseases of competition, detrimental to the whole public. For the police power embraces all regulations designed to promote the general welfare or prosperity. See *Chicago, etc. Ry. Co. v.*

Drainage Commissioners, 200 U. S. 561, 592; *Noble State Bank v. Haskell*, 219 U. S. 104, 111; *Eubank v. City of Richmond*, 226 U. S. 137, 142. Such legislation will not be overthrown by the courts unless utterly unreasonable or purely arbitrary. *Otis v. Parker*, 187 U. S. 606; *McLean v. Arkansas*, 211 U. S. 539. See *Schmidinger v. Chicago*, 226 U. S. 578, 587, 588. Likewise, if there is any reasonable ground for the classification adopted, the equal protection clause of the Fourteenth Amendment is not violated. *Lindsley v. Natural Carbonic Gas Co.*, 220 U. S. 61; *International Harvester Co. v. Missouri*, 234 U. S. 199. Nor need a statute cover the whole field of possible abuses in order to hit what the legislature deems an evil. *Central Lumber Co. v. South Dakota*, 226 U. S. 157; *Keokee Coke Co. v. Taylor*, 234 U. S. 224. There clearly is sufficient difference in fact between the use of trading stamps and ordinary advertising to afford a reasonable basis for a legislative discrimination. It is to be hoped that the principal cases mark the turning of the tide on this question.''

§35. *Specially Regulated Trades.*—Express, telephone and telegraph companies, banks, railroads, insurance companies and enterprises engaged in supplying light, heat, power and water—because of the vast social and public interests involved in their conduct—and mines and factories—because of the danger to life and limb involved in their operations—are everywhere the subjects of special regulative statutes. In most states administrative boards and commissions with wide discretionary powers, sometimes amounting to arbitrary power over the very life of a business enterprise, have been created. In general, however, these boards are checked and controlled not only by their answerability to the executive who appoints them and indirectly to the voters, but also by a very extensive system of judicial review. Under the Anglo-American ''rule of law,'' officers are not immune from answerability to the courts.[1] Accordingly they may be kept strictly within their jurisdiction and abuse of discretion may be prevented in the following ways:

1. Political answerability of officers to those who appoint or elect them.

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[1]Dicey, *Law of the Constitution*, 8th ed. 1915; cf. §2 *supra*.

2. Civil or criminal proceedings against officers.
3. Civil judicial review.
   (a) Independent attack on administrative decisions, either
      (x) direct, as on
         (1) Mandamus
         (2) Prohibition
         (3) Quo warranto
         (4) Certiorari
         (5) Habeas corpus
         (6) Injunction
         (7) Taxpayer's bill or other
         (8) Specially provided statutory proceedings, or
      (y) indirect, where a finding of the administrative is relied on in a suit between two persons.
   (b) true review,
      (x) where the administrative applies to the court for enforcement of its decree;
      (y) where a statute provides for a quasi appeal or error proceedings in courts.

In the case of several of these businesses the Federal Government has acquired a great degree of control through the liberal interpretation accorded the interstate commerce clause of the Constitution of the United States. By Article I, Section 8, Congress is given power to "regulate commerce with foreign nations, and among the several states, and with the Indian Tribes." Whatever that clause may have meant in 1787, it now embraces, under our modern system of intercommunication among the different parts of the country, by far the most significant part of the commerce of the country. The Interstate Commerce Commission, created by an act of Congress in 1887, one hundred years after the drafting of the Constitution, now regulates the arteries of transportation and communication throughout the country. Another Federal board, the Federal Trade Commission, created in 1914, has powers to inquire into "unfair methods of competition" by persons engaged in interstate trade. Up to May, 1920, this commission had made complaints against 601 business concerns because of alleged unfair business practices. In a sense all interstate trade is specially regulated, because Congress in the exercise of its Constitutional power has from time to time made enactments affecting it, such as the Sherman Anti-Trust Law (1890), the Food and Drugs Act

(1906) and the like. Banking has been brought largely under Federal control by the taxing of state bank currency out of existence, then by the National Bank Act and finally by the Federal Reserve Banking Act with its powerful Federal Reserve Board. Strangely enough insurance has escaped Federal control through an early decision that insurance was not "commerce."

§36. *From Robert R. Reed, "Blue Sky" Laws, in An. Am. Acad. Pol. and Soc. Sci., March,* 1920.—[That the so-called right to engage in business is at least subject to marked and growing limitations in favor of the state and society, is further illustrated by the widespread enactment of so-called "blue-sky laws" imposing restrictions on the business of dealing in securities.] "The breathing spell and check given by the decisions holding the earlier laws invalid has been followed by the enactment of new statutes, eliminating the more obvious crudities of the earlier laws but in the main adhering to the original principle of executive control. It is not feasible to present the details of specific acts, but we can perhaps outline what may be called the prevailing type of a regulative law, the constitutionality of which has been sustained by the supreme court.

The law prohibits the offering or sale of securities, with certain exemptions, except under the conditions prescribed by it. A violation is punishable, and may also have the effect of making a sale illegal, with a resulting suit for recovery of the purchase price (*Edwards v. Ioor,* 205 Mich. 617), and possibly for the recovery of damages against all parties concerned. The dealer in securities must secure an annual license, the granting of which is discretionary and revocable. This requires a fee and a large amount of detailed information, most of which, it may be assumed, is never read by the state official if he knows that the dealer is a recognized financial house. This law applies to all issuers of and dealers in securities. A non-resident issuer or dealer having no office in the state is an issuer or dealer under the law if he offers or sells securities in the state.

' Before offering a particular security in a 'blue sky' state the issuer or dealer must determine whether the law applies to

that security. Certain kinds of sales, such as sales by the owner not in the course of repeated transactions, sales to a bank or dealer and new stock issues to existing stockholders, are exempt. Certain classes of securities are also exempt, including governmental and municipal bonds, approved public utility securities and securities senior thereto; securities listed and dealt in on approved exchanges or regularly quoted in newspapers for a year, and securities senior thereto; also certain classes of local securities, such as bank stocks, commercial paper and first mortgage bonds on real estate in the state. Manifestly many sound and necessary investment offerings are not included in these exemptions.

If the security is subject to the law, the application for leave to offer it must be accompanied by a fee based on the amount proposed to be offered in the state. Detailed information as to the issuing company, its character, powers, properties, stock issues and business, is required to be furnished. A state official must be designated for service of process on the applicant in any future suit. Additional information may be required either in the first instance or from time to time. Appraisals and audits may be required, or an official investigation of properties made, without limit as to expense, but *all at the expense of the applicant.* The Securities Commission must examine the information furnished. Presumably it must continue its examination until it is satisfied that the proposed sale will not 'constitute a fraud,' or 'work a fraud' on the purchaser. It then issues a permit or license under which the securities in a named amount may be sold within the state. It is possible and usual in proper cases for it to condition the permit. This it may do indirectly by requiring the applicant to file a statement that the securities are to be sold under certain conditions, for instance, at not exceeding a named price. The law also empowers the commission to require the cancellation of any stock issued for property in excess of what it considers a fair value, and to require a deposit in escrow of any promoters' stock, to prevent its being sold prior to the fulfilment of prescribed conditions, or the demonstration of earning power over a given period. The permit to sell, like the dealer's general license, may be revoked

for cause. It is required to be revoked if the licensee at any time refuses desired information, or refuses to sanction an expert investigation of his business or properties (possibly in Peru) at his own expense. Appeals may be taken to the courts to compel the issuance or prevent the revocation of a license. This type of act has been sustained by the supreme court.''

§37 *HAMILTON-BROWN SHOE COMPANY v. THE WOLF BROTHERS COMPANY.*

Supreme Court of the United States, 1916. [240 *U. S.* 251.]

PITNEY J.: Respondent, an Ohio corporation engaged in the manufacture of shoes, filed its bill of complaint on January 29, 1906, in the Circuit Court of the United States for the Eastern District of Missouri, Eastern Division, against petitioner, a Missouri corporation engaged in the same business, seeking an injunction to restrain infringement of an alleged trade-mark for shoes consisting of the words ''The American Girl,'' by the use of the words ''American Lady'' as a colorable imitation, and also unfair competition in trade, carried on by means that included the use of the latter words; and praying an accounting of damages and profits. On final hearing the Circuit Court dismissed the bill. Upon appeal, the Circuit Court of Appeals (165 Fed. 413) held that ''The American Girl'' was a geographical name, and, as applied to women's shoes, was descriptive merely of shoes manufactured in America and to be worn by women, and not an arbitrary or fanciful name to indicate the maker, and hence that the term as applied to shoes was not the subject of a valid trade-mark. But the court held that complainant was entitled to be protected against unfair trade; that the record disclosed that it and its predecessors in business had employed the words ''The American Girl'' as a trade-mark continuously since the year 1896, had extensively advertised their shoes under that name, with the catch phrase ''A shoe as good as its name,'' in trade journals and newspapers throughout the United States, and largely throughout the southern states, and thus established an extensive trade therefor; and that defendant by adopting in the year 1900 and thereafter using the name ''The American Lady,'' with certain catch phrases, in connection with shoes made by it, and this with full knowledge of complainant's rights, was guilty of unfair competition, tending to and resulting in confusion in the trade, and that complainant was entitled to relief. The decree of the Circuit Court was therefore reversed, with directions to decree an injunction and

an accounting limited to the time since the commencement of the suit.

Complainant petitioned this court for a writ of certiorari to review that decision, but this was denied. 214 U. S. 514.

Thereafter the Circuit Court, pursuant to the mandate of the Court of Appeals, made a decree granting an injunction in accordance with the opinion of that court, and referring to a master an accounting of the damages and profits for which defendant might be liable, "limited to shoes sold by the defendant since the filing of the bill in this case, and which were marked with the name 'American Lady,' and not accompanied with any other matter clearly indicating that such shoes were of the manufacture of the Hamilton-Brown Shoe Company." An accounting was had, extending from the date of the commencement of the suit to March 10, 1910. Complainant made no attempt to introduce substantial proof as to the amount of its damages, declaring that they were practically incapable of exact computation. All the testimony was directed to the question of defendant's profits.

The master reported that during the period covered by the accounting defendant sold "American Lady" shoes, which, because of differences in marking, he divided into three classes:

Class 1. 974,016 pairs of shoes bearing the words "American Lady" stamped upon the sole, and bearing no other impression or distinguishing mark. The profits upon these were found to be $254,401.72.

Class 2. 961,607 pairs of shoes marked "American Lady," with the words "Hamilton-Brown Shoe Co," but without the word "Makers" or other matter indicating that the shoes were of defendant's manufacture. The profits upon these were found to be $190,909.83.

Class 3. 593,872 pairs of shoes marked "American Lady," but bearing also the marks "Hamilton-Brown Shoe Co., Makers." The profits upon these were found to be $132,740.77.

The master recommended that a judgment be entered for the profits accruing from the first two classes, aggregating $445,-311.55. The profits accruing from the third class he held complainant was not entitled to recover under the opinion of the Court of Appeals and the decree of the Circuit Court entered in accordance with it. Both parties having filed exceptions, the District Court (successor of the Circuit Court), overruled those of complainant, sustained those of defendant, and adjudged a recovery of $1 nominal damages. 192 Fed. 930.

Complainant appealed to the Circuit Court of Appeals, contending that a decree should have been rendered in its favor for

the profits upon the first two classes of shoes, in accordance with the master's recommendation, and that it should have included the profits upon the third class, which were denied by the master. The Court of Appeals reversed the decree, with directions that defendant's exceptions to the master's report be overruled, that the report be confirmed, and that a decree be entered against defendant for the amount recommended by him, with costs. 206 Fed. 611.

This writ of certiorari having been allowed, we proceed to deal with the questions presented by the record.

Regarding the case as one of unfair competition without trade-mark infringement, it is insisted by petitioner that the normal recovery does not include the gains and profits of defendant, according to the rule admittedly applicable in equity to trade-mark cases, but that the injured party is limited to such damages as it shows it has sustained; and that the present case is devoid of circumstances to take it out of the ordinary rule.

If, however, complainant was and is entitled to the use of the words "The American Girl" as a trade-mark, in the strict sense of the term, and if the proofs adduced before the master, and his findings thereon, are as applicable to a claim of compensation for infringement of the trade-mark as to a claim of compensation for unfair competition in the absence of trade-mark, it will not be necessary to pass upon the question of the proper measure of recovery in a non-trade-mark case. As above pointed out, a claim of trade-mark right was asserted in the bill, and it has not been abandoned. It was overruled by the Circuit Court of Appeals on the first appeal, upon reasoning with which we are unable to concur. We do not regard the words "The American Girl," adopted and employed by complainant in connection with shoes of its manufacture, as being a geographical or descriptive term. It does not signify that the shoes are manufactured in America, or intended to be sold or used in America, nor does it indicate the quality or characteristics of the shoes. Indeed, it does not, in its primary signification, indicate shoes at all. It is a fanciful designation, arbitrarily selected by complainant's predecessors to designate shoes of their manufacture. We are convinced that it was subject to appropriation for that purpose, and it abundantly appears to have been appropriated and used by complainant and those under whom it claims.

The cases cited to the contrary are distinguishable. In *Canal Co. v. Clark,* 13 Wall. 311, 324, the word "Lackawanna" was rejected as a trade-mark for coal because it designated the district in which the coal was produced. In *Columbia Mill*

Company v. Alcorn, 150 U. S. 460, 466, it was held that "Columbia" could not be appropriated for exclusive use as a trade-mark because it was a geographical name. So, with respect to "Elgin," as designating watches, *Elgin Natl. Watch Co. v. Illinois Watch Co.,* 179 U. S. 655, 673; "Genessee," claimed as a trade-mark for salt, *Genessee Salt Co. v. Burnap,* 73 Fed. 818; "Old Country," as a mark for soap, *Allen B. Wrisley Co. v. Iowa Soap Co.,* 122 Fed. 796. If the mark here in controversy were "American Shoes," these cases would be quite in point. (And see *Shaver v. Heller & Merz Co.,* 108 Fed. 821, 826.) But "The American Girl" would be as descriptive of almost any article of manufacture as of shoes; that is to say, not descriptive at all. The phrase is quite analogous to "American Express," held to be properly the subject of exclusive appropriation as a trade-mark for sealing wax in *Dennison Mfg. Co. v. Thomas Mfg. Co.,* 94 Fed. 651, 653. . . .

Having reached the conclusion that complainant is entitled to the use of the words "The American Girl" as a trade-mark, it results that it is entitled to the profits acquired by defendant from the manifestly infringing sales under the label "American Lady," at least to the extent that such profits are awarded in the decree under review. The right to use a trade-mark is recognized as a kind of property, of which the owner is entitled to the exclusive enjoyment to the extent that it has been actually used. *McLean v. Fleming,* 96 U. S. 245, 252; *Manhattan Medicine Co. v. Wood,* 108 U. S. 218, 224. The infringer is required in equity to account for and yield up his gains to the true owner, upon a principle analogous to that which charges a trustee with the profits acquired by wrongful use of the property of the *cestui que trust.* Not that equity assumes jurisdiction upon the ground that a trust exists. As pointed out in *Root v. Railway Co.,* 105 U. S. 189, 14, and *Tilghman v. Proctor,* 125 U. S. 136, 148 (patent cases), the jurisdiction must be rested upon some other equitable ground—in ordinary cases, as in the present, the right to an injunction—but the court of equity, having acquired jurisdiction upon such a ground, retains it for the purpose of administering complete relief, rather than send the injured party to a court of law for his damages. And profits are then allowed as an equitable measure of compensation, on the theory of a trust *ex maleficio.* In the courts of England, the rule seems to be that a party aggrieved must elect between damages and profits, and cannot have both. In this country, it is generally held that in a proper case both damages and profits may be awarded. As already observed, the decree under review allows profits only, confines the allowance

to such as accrued after the commencement of the suit, and excludes all sales where the term "American Lady" was accompanied with any other matter clearly indicating that such shoes were of the manufacture of the Hamilton-Brown Shoe Company. It was construed to exclude all shoes bearing in addition to "American Lady" the marks "Hamilton-Brown Shoe Co., Makers." The account was based upon undisputed data, and no reason is suggested why, if otherwise accurate, it is not as properly applicable upon the theory of trade-mark as upon that of unfair competition aside from trade-mark infringement —at least, so far as defendant is entitled to criticise it; complainant is not attacking the decree.

It is, however, insisted by defendant (petitioner) that whether the recovery be based upon the theory of trade-mark, or upon that of unfair competition, the profits recoverable should be limited to such amount as may be shown by direct and positive evidence to be the increment of defendant's income by reason of the infringement, and that the burden of proof is upon complainant to show what part of defendant's profits were attributable to the use of the infringing mark. It is said the true rule is strictly analogous to that applied in patent cases, and *Mowry v. Whitney,* 14 Wall. 620, 650; *Elizabeth v. Pavement Co.,* 97 U. S. 126, 139; *Garretson v. Clark,* 111 U. S. 120, 121; *Dobson v. Hartford Carpet Co.,* 114 U. S. 439, 444; *Tilghman v. Proctor,* 125 U. S. 136, 146; *Keystone Mfg. Co. v. Adams,* 151 U. S. 139, 147; *Westinghouse Co. v. Wagner Mfg. Co.,* 225 U. S. 604, 615; and *Dowagiac Mfg. Co. v. Minnesota Plow Co.,* 235 U. S. 641, are relied upon. The rule invoked is that which, as pointed out in the last two of these cases, is applicable where plaintiff's patent relates to a part only of a machine or combination or process, or to particular improvements in a machine or other device. In such case, where the invention is used in combination with other elements of value not covered by the patent, so that plaintiff's patent creates only a part of the profits, he is entitled to recover only that part, and must give evidence tending to apportion the profits between the patented and unpatented features. But, as pointed out in the Westinghouse case (p. 618), there is a recognized exception where the plaintiff carries the burden of proof to the extent of showing the entire profits, but is unable to apportion them, either because of the action of the wrongdoer in confusing his own gains with those which belong to plaintiff, or because of the inherent impossibility of making an approximate apportionment. There, "on established principles of equity, and on the plainest principles of justice, the guilty trustee cannot take advantage of his own wrong."

Assuming the asserted analogy to patent cases to exist, a sufficient reason for not requiring complainant in the present case to make an apportionment between the profits attributable to defendant's use of the offending mark and those attributable to the intrinsic merit of defendant's shoes is that such an apportionment is inherently impossible. Certainly, no formula is suggested by which it could be accomplished. The result of acceding to defendant's contention, therefore, would be to deny all compensation to complainant. And it is to be remembered that defendant does not stand as an innocent infringer. Not only do the findings of the Court of Appeals, supported by abundant evidence, show that the imitation of complainant's mark was fraudulent, but the profits included in the decree are confined to such as accrued to defendant through its persistence in the unlawful simulation in the face of the very plain notice of complainant's rights that is contained in its bill. As was said by the Supreme Court of California in a similar case, *Graham v. Plate*, 40 Cal. 593, 598; 6 Am. Rep. 639, 640: "In sales made under a simulated trade-mark it is impossible to decide how much of the profit resulted from the intrinsic value of the commodity in the market, and how much from the credit given to it by the trade-mark. In the very nature of the case it would be impossible to ascertain to what extent he could have effected sales and at what prices except for the use of the trade-mark. No one will deny that on every principle of reason and justice the owner of the trade-mark is entitled to so much of the profit as resulted from the use of the trade-mark. The difficulty lies in ascertaining what proportion of the profit is due to the trade-mark, and what to the intrinsic value of the commodity; and as this cannot be ascertained with any reasonable certainty, it is more consonant with reason and justice that the owner of the trade-mark should have the whole profit than that he should be deprived of any part of it by the fraudulent act of the defendant. It is the same principle which is applicable to a confusion of goods. If one wrongfully mixes his own goods with those of another, so that they cannot be distinguished and separated, he shall lose the whole, for the reason that the fault is his; and it is but just that he should suffer the loss rather than an innocent party, who in no degree contributed to the wrong." To the same effect are *Avery v. Meikle*, 85 Ky. 435, 448; 7 Am. St. Rep. 604, 610; *El Modello Cigar Mfg. Co. v. Gato*, 25 Fla. 886, 915; 23 Am. St. Rep. 537, 544; 6 L. R. A. 823, 829; *Regis v. Jaynes & Co.*, 191 Mass. 245, 249, 251; *Shoe Co. v. Shoe Co.*, 100 Me. 461, 479; *Saxlehner v. Eisner & Mendleson Co.*, 138 Fed. 22, 24.

Finally, it is contended that the account as stated by the

master and confirmed by the Circuit Court of Appeals failed to make due allowance for certain items entering into the cost of manufacturing and selling the shoes in diminution of defendant's profits, including interest on capital, depreciation of real estate, taxes, insurance, advertising, and trade discounts. These are matters of fact, respecting which we see no sufficient reason for disturbing the decree. One of the points most earnestly insisted upon is that certain overhead charges, appearing on defendant's books as "Advance Boston House, $73,772.03" and "Allowance to Boston, $103,075.14," of which the amount chargeable *pro rata* against "American Lady" shoes not marked "Makers," for the period covered by the accounting, was $10,271.69, ought to have been deducted in computing defendant's profits. The only explanation of these charges is in a stipulation of the parties that they "represent allowances made by the wholesale house of Hamilton-Brown Shoe Company on goods shipped by it to what is known as the 'Boston House,' being a separate and distinct corporation from the defendant company, and the amount received by the Hamilton-Brown Shoe Company from the 'Boston House' for goods shipped to it was $73,772.03 and $103,075.14 less than the price at which the goods were billed to that house, and those items do not represent moneys paid by the Hamilton-Brown Shoe Company to the 'Boston House' or advances by the Hamilton-Brown Shoe Company to the 'Boston House.'" If, in the Master's calculation of the profits, defendant had been charged with sales of the goods at the prices at which they were billed to the Boston House, the insistence that a deduction of $10,271.69 ought to be allowed as being in the nature of a trade discount would seem correct. But that is not made to appear, and we cannot conclude that the Master erred in overruling this allowance.

Decree affirmed.

The Chief Justice and Mr. Justice Van Devanter are of opinion that the term "The American Girl," as applied to women's shoes made and sold in America, is geographical and descriptive and not subject to exclusive appropriation as a trademark, and that upon this record a recovery of the entire profit is not admissible. They, therefore, dissent.

§38 *AMERICAN WALTHAM WATCH COMPANY v. UNITED STATES WATCH CO.*

Supreme Judicial Court of Mass., 1899. [173 *Mass.* 85.]

Bill in equity, filed October 15, 1890, and amended September 22, 1898, to restrain the use of the word "Waltham" on

watches made by the defendant, to the detriment of the plaintiff's business as a manufacturer of watches in Waltham. Hearing before Knowlton, J., who, with the consent of the parties, reported the case for the consideration of the full court. The facts appear in the opinion.

HOLMES, J.: This is a bill brought to enjoin the defendant from advertising its watches as the "Waltham Watch" or "Waltham Watches," and from marking its watches in such a way that the word "Waltham" is conspicuous. The plaintiff was the first manufacturer of watches in Waltham, and had acquired a great reputation before the defendant began to do business. It was found at the hearing that the word "Waltham," which originally was used by the plaintiff in a merely geographical sense, now, by long use in connection with the plaintiff's watches, has come to have a secondary meaning as a designation of the watches which the public has become accustomed to associate with the name. This is recognized by the defendant so far that it agrees that the preliminary injunction, granted in 1890, against using the combined words "Waltham Watch" or "Waltham Watches" in advertising its watches, shall stand and shall be embodied in the final decree.

The question raised at the hearing, and now before us, is whether the defendant shall be enjoined further against using the word "Waltham," or "Waltham, Mass.," upon the plates of its watches without some accompanying statement which shall distinguish clearly its watches from those made by the plaintiff. The judge who heard the case found that it is of considerable commercial importance to indicate where the defendant's business of manufacturing is carried on, as it is the custom of watch manufacturers so to mark their watches, but nevertheless found that such an injunction ought to issue. He also found that the use of the word "Waltham," in its geographical sense, upon the dial, is not important, and should be enjoined.

The defendant's position is that, whatever its intent, and whatever the effect in diverting a part of the plaintiff's business, it has a right to put its name and address upon its watches; that to require it to add words which will distinguish its watches from the plaintiff's in the mind of the general public is to require it to discredit them in advance; and that, if the plaintiff by its method of advertisement has associated the fame of its merits with the city where it makes its wares instead of with its own name, that is the plaintiff's folly, and cannot give it a monopoly of a geographical name, or entitle it to increase the defendant's burdens in advertising the place of its works.

In cases of this sort, as in many others, what ultimately is

to be worked out is a point or line between conflicting claims, each of which has meritorious grounds and would be extended further were it not for the other. *Boston Ferrule Co. v. Hills*, 159 Mass. 147, 149, 150. It is desirable that the plaintiff should not lose custom by reason of the public mistaking another manufacturer for it. It is desirable that the defendant should be free to manufacture watches at Waltham, and to tell the world that it does so. The two desiderata cannot both be had to their full extent, and we have to fix the boundaries as best we can. On the one hand, the defendant must be allowed to accomplish its desideratum in some way, whatever the loss to the plaintiff. On the other, we think the cases show that the defendant fairly may be required to avoid deceiving the public to the plaintiff's harm, so far as is practicable in a commercial sense.

It is true that a man cannot appropriate a geographical name, but neither can he a color, or any part of the English language, or even a proper name to the exclusion of others whose names are like his. Yet a color in connection with a sufficiently complex combination of other things may be recognized as saying so circumstantially that the defendant's goods are the plaintiff's as to pass the injunction line. *New England Awl & Needle Co. v. Marlborough Awl & Needle Co.*, 168 Mass. 154, 156. So, although the plaintiff has no copyright on the dictionary or any part of it, he can exclude a defendant from a part of the free field of the English language, even from the mere use of generic words unqualified and unexplained, when they would mislead the plaintiff's customers to another shop. *Reddaway v. Banham*, [1896] A. C. 199. So the name of a person may become so associated with his goods that one of the same name coming into the business later will not be allowed to use even his own name without distinguishing his wares. *Brinsmead v. Brinsmead*, 13 Times L. R. 3. *Reddaway v. Banham*, [1896] A. C. 199, 210. See *Singer Manuf. Co. v. June Manuf. Co.*, 163 U. S. 169, 204; *Allegretti Chocolate Cream Co. v. Keller*, 85 Fed. Rep. 643. And so, we doubt not, may a geographical name acquire a similar association with a similar effect. *Montgomery v. Thompson*, [1891] A. C. 217.

Whatever might have been the doubts some years ago, we think that now it is pretty well settled that the plaintiff, merely on the strength of having been first in the field, may put later comers to the trouble of taking such reasonable precautions as are commercially practicable to prevent their lawful names and advertisements from deceitfully diverting the plaintiff's custom.

We cannot go behind the finding that such a deceitful diversion is the effect and intended effect of the marks in question.

We cannot go behind the finding that it is practicable to distinguish the defendant's watches from those of the plaintiff, and that it ought to be done. The elements of the precise issue before us are the importance of indicating the place of manufacture and the discrediting effect of distinguishing words on the one side, and the importance of preventing the inferences which the public will draw from the defendant's plates as they now are, on the other. It is not possible to weigh them against each other by abstractions or general propositions. The question is specific and concrete. The judge who heard the evidence has answered it, and we cannot say that he was wrong.

Decree for the plaintiff.

§39. *From E. S. Rogers. Goodwill, Trade-marks and Unfair Trading. Pp.* 162 *ff.*—Walter Baker & Company has been in business for over a century, so that Baker's Cocoa and Baker's Chocolate were the names by which its products were known; that is to say, Baker's Chocolate did not mean a product made by a man named "Baker" as distinguished from a product made by a man named Robinson, but indicated a certain specific article of approved excellence. William Henry Baker, who was a grocer in Winchester, Virginia, in the months of May and June of 1894 had several conferences with J. Elwood Sanders, then in the employ of Rockwood & Company, manufacturers of chocolate. Baker engaged the services of Sanders, and commenced the sale of chocolate which he had made for him. A partnership was at that time contemplated between himself and Sanders and the firm name of W. H. Baker & Co. adopted. That partnership was not formed. Walter Baker & Co. had a brand called "German Sweet Chocolate." William Henry Baker immediately started with a "Germania Sweet Chocolate."

[Walter Baker & Co.'s cooking chocolate and William Henry Baker's bitter chocolate were issued under similar yellow labels.]

A suit was started by Walter Baker & Co. and an injunction obtained against these obviously fraudulent practices and against the use of the name "Baker's" alone, and William Henry Baker was required to use the full name of "W. H. Baker" or "W. H. Baker's" and was restrained from using any yellow label. He thereupon changed his label and substituted for the

yellow label one light blue in color with the ingenious statement "Best quality now with the blue label." . . .

Of course this second label was not less fraudulent than the first, though considerably more ingenious, and it was evident that a further restraint was necessary. The Court of Appeals held that William Henry Baker "should not be allowed to use his surname Baker whether his given name or its initials are prefixed or not, so as to announce upon label or advertisement that the goods he sells are Baker's Chocolate." An alternative form of injunction was suggested, allowing the defendant to continue the label as before upon condition that there be affixed to every package sold, in type as prominent as the title, the statement "W. H. Baker is distinct from and has no connection with the old chocolate manufacturer, Walter Baker & Co." . . .

The result of this litigation is instructive in showing how deception persists even when hedged around with what seems *a priori* the most ample safeguards, because William Henry Baker's product in the above dress, which was judicially approved, and was doubtless thought to be sufficiently distinguished to prevent deception and mistake, was systematically advertised and sold by Charles H. Slack, a Chicago grocer, as "Baker's Chocolate" and passed out to people who asked for "Baker's Chocolate," and it was not until the Circuit Court of Appeals had passed upon it that adequate relief was obtained and the public protected from imposition. That Court held that Baker's Chocolate meant Walter Baker's; that the William Henry Baker product, even under the label bearing the announcement of distinction, could not lawfully be sold as Baker's Chocolate, and that the announcement was not sufficient to protect the purchaser from imposition when the article was passed out at a retail store in response to requests for Baker's Chocolate.

However sedulously the courts at the present time attempt to permit a new trader to use his name where that name is a famous one in the line of business adopted, they do not shrink from restricting that use where the only result of permitting it would be to deceive the public and purloin an established trade. It is always argued by defendants in opposition to attempts to

limit or restrict the use of personal names, that the name is the defendant's own and from this premise it is sought to draw the conclusion that every consequence arising from the use of the name is lawful. That fallacy involved in this conclusion has been exposed in these cases time and time again. Of course, the defendant's name is his own. This ought not to give him any more right to perpetrate a fraud by means of it than to perpetrate a fraud in any other way. The fact that it is his own name makes no difference; ownership is not a license unnecessarily to injure another. Blackbeard was none the less a pirate because he owned the ship in which he made his cruises along the Spanish main.[1]

§40 *HIGGINS CO. v. HIGGINS SOAP CO.*

Court of Appeals of New York, 1895. [144 *N. Y.* 462.]

ANDREWS, Ch. J.: The plaintiff seeks in this action to restrain the use by the defendant in this state of its corporate name, "Higgins Soap Company," in the business of manufacturing and selling soap, on the ground that such use is an unlawful invasion of the rights of the "Chas. S. Higgins Company," the plaintiff corporation. The corporate names of the respective corporations are not identical, but it is claimed in behalf of the plaintiff that there is a similarity between them which, in connection with other facts, is liable to and has produced confusion and will enable the defendant to appropriate the trade of the plaintiff. The facts found show that in 1890, prior to the organization of the corporation defendant, under the laws of New Jersey, which took place in 1892, the plaintiff, a domestic corporation, organized by Charles S. Higgins and others, purchased from Charles S. Higgins and his partner, for the sum of $810,000 in stock and bonds, the soap business originally established in Brooklyn by the father of Charles S. Higgins in 1846, to which business Charles S. Higgins succeeded on his father's death in 1860, together with the good will, labels, trade-marks and other property employed in the business. The business was very valuable, and the plaintiff and its predecessor expended, subsequent to 1879, in advertising, the sum of three

[1][See *Walter Baker & Co., Ltd. v. Baker,* 77 Fed. R. 181 (C. C. 1896); *Walter Baker & Co., Ltd. v. Sanders,* 80 Fed. R. 889 (C. C. 1897); *Walter Baker & Co., Ltd. v. Baker,* 89 Fed. R. 673 (C. C. 1898); *Walter Baker & Co., Ltd. v. Baker,* 87 Fed. R. 209 (C. C. 1898); *Baker v. Slack,* 130 Fed. R. 514 (C. C. A. 1904).]

hundred thousand dollars, and the product was extensively sold in New York and other states and was well known to the trade as "Higgins Soap," and the plaintiff corporation was sometimes known as the "Higgins Soap Company." The plaintiff and its predecessors manufactured a great variety of soaps, which were put up under different names, the leading article being known as "Chas. S. Higgins German Laundry Soap," but as we infer from the findings, all the soap so manufactured passed under the general name of "Higgins Soap." On the organization of the plaintiff corporation and the purchase of the business, it continued to carry it on in Brooklyn, where it had been originally established, and where it has ever since been carried on. Charles S. Higgins was a director of the plaintiff and its first president, and so continued for a year after its incorporation, when he was displaced from his position as president and ceased to be a director of the company. The ground of his discharge does not appear. Soon afterwards, in the summer of 1892, Charles S. Higgins, with his wife, his son and two other persons, organized the defendant corporation under the name of the "Higgins Soap Company," to carry on the soap business, and commenced the manufacture of soap, having its factory, principal office and place of business outside of New Jersey, in the city of Brooklyn. Charles S. Higgins became the president of the defendant corporation, and among other products it manufactured and put up a soap in bars, on the wrappers of which appear the words "Higgins Soap Company, Original Laundry Soap, Charles S. Higgins, Pres.," and the bars were impressed with substantially the same words.

It was shown on the trial that letters intended for the plaintiff, containing orders for goods, or relating to other business matters had been sent addressed to the "Higgins Soap Company," "Chas. S. Higgins Soap Co.," and "Chas. Higgins Co.," but in general the plaintiff's place of business was added to the address and they were received by the plaintiff. There were produced 28 letters and envelopes of this kind, written within four months after the organization of the defendant and the commencement of this action, and it was stated that these did not comprise all the letters of this description.

The main ground upon which the plaintiff has been defeated in the courts below is that Charles S. Higgins or the members of his family, either separately or jointly, had the right to establish the soap business and to use the name of Higgins in conducting it, and to designate the product as "Higgins Soap," and that no right of the plaintiff was invaded by giving to

the corporation formed by them the name of "Higgins Soap Company." . . .

Whether the court will interfere in a particular case must depend upon circumstances; the identity or similarity of the names; the identity of the business of the respective corporations; how far the name is a true description of the kind and quality of the articles manufactured or the business carried on; the extent of the confusion which may be created or apprehended, and other circumstance which might justly influence the judgment of the judge in granting or withholding the remedy. . . . The inference seems irresistible that the defendant assumed its corporate name so that it should carry the impression that it was the manufacturer of "Higgins Soap," so well known to the public. But if the name was assumed in good faith, and without design to mislead the public and acquire the plaintiff's trade, the defendant, knowing the facts, must be held to the same responsibility as if it acted under the honest impression that no right of the plaintiff was invaded. The names are not identical, but, as said by BRADLEY, J., in *Celluloid Co. v. Cellonite Co.*, 32 Fed. 94, "Similarity, not identity, is the usual recourse where one party seeks to benefit himself by the good name of another." In that case the learned and experienced judge who sat therein expressed the opinion that the use of the corporate name of the defendant should be restrained, although there was a much greater dissimilarity between the names there in question than exists between the names of the parties here. As between these parties the case is, we think, the same as if the word "soap" was written into the plaintiff's name and its corporate designation was "Chas. S. Higgins Soap Company." The evidence shows that confusion has arisen, and it is a reasonable presumption that if the defendant is permitted to continue to carry on the business of soap making under its present name the public will be misled and the plaintiff's trade diverted, the extent of such diversion increasing with the increase of the defendant's business.

We think the plaintiff, upon the facts found and proved, was entitled to relief by injunction.

The judgment should be reversed and a new trial granted.

§41. *Personal Names.*—Originally a name was only a convenient method of distinguishing individuals from one another, and being selected arbitrarily by the bearer, could be abandoned at his caprice. This early common law doctrine persists today; a change of name requires no particular formalities, such stat-

utes as there are being usually permissive and not prohibitive.

See Arnold, *Personal Names,* 15 Yale L. J. 227; Steiner, *A Man and His Name, ibid* 341. *Cf.* also 26 Sol. Jour. 689, and *Laflin v. Steytler,* §345, *infra.*

In the naming of corporations the state exercises a more direct control. In a number of states the adoption of a corporate name by a domestic corporation is prohibited if the name is likely to be confused with that of an existing corporation.

§42. *Rev. Laws Mass.* (1902), ch. 72, sec. 5. A person who carries on business in this commonwealth shall not assume or continue to use in his business the name of a person formerly connected with him in partnership or the name of any other person, either alone or in connection with his own or with any other name or designation, without the consent in writing of such person or his legal representatives.

§43 *PREST-O-LITE CO. v. AVERY PORTABLE LIGHTING CO.*

U. S. Circuit Court, N. D. New York, 1908. [161 *Fed.* 648.]

[The Avery Portable Lighting Co. undertook to refill Prest-o-Lite tanks with acetylene gas. Its practice was to paste a label over the Prest-o-Lite Co.'s name plate, reading as follows: "This tank has been refilled with Acetylene Gas by the Avery Portable Lighting Co., Milwaukee, Wisconsin, Albany, New York, manufacturers of Autogas Tanks." The Prest-o-Lite Co. sought to have this practice enjoined.]

RAY, District Judge: The defendant is a competing company in this business and has a tank of its own which it can and does fill with its own gas, described and advertised as "Autogas." Avery, of the defendant company, was formerly with the complainant company, and is familiar with its business methods.

It is evident to me that the defendant pursues this method and gets hold of these "Prest-o-Lite" gas tanks and passes them out to its customers for the purpose of taking trade from the complainant company. It in no way changes the appearance of the tank, except by pasting on the label, easily removed, and which only covers a part of the plate, and when it says, "This tank has been refilled with acetylene gas by the Avery Portable Lighting Company," etc., it implies and fairly represents to the purchaser not only that he is getting acetylene gas made by the Prest-o-Lite Company, but that he is obtaining a properly re-

filled "Prest-o-Lite gas tank." When the lower part of the plate is not covered by the label, surely the user or purchaser recognizes it as a "Prest-o-Lite gas tank," and will naturally assume that it holds "Prest-o-Lite gas," and this is especially true as the defendant company has a different tank of its own make bearing a different plate and the purchasers will naturally assume that, when they take a "Prest-o-Lite tank," they get Prest-o-Lite acetylene gas properly placed therein, and that when they take an "Autogas tank," they obtain Autogas properly placed therein. The natural result is that would-be purchasers of the Prest-o-Lite gas get Autogas imperfectly placed in the Prest-o-Lite tank. If the purchaser has doubts that he is getting a Prest-o-Lite tank properly filled with Prest-o-Lite gas, he easily scrapes off the label, and, finding the complainant's trade-mark "Prest-o-Lite," he feels assured he has obtained what he desired. I think, and am constrained to hold, that this is an improper use of these tanks bearing complainant's trade-marks, and that these acts constitute unfair competition in trade, and should be restrained. It would be easy and not expensive to remove the engraved plate from the tanks and prevent confusion and imposition. If defendant company would use these tanks, it should do this. I am not passing on the question of infringement of the patents where there has been a violation of the license notice now placed on the copper plates attached to the tanks. I am bound to presume that the patents are valid, but that question is not before me. Complainant's trade-mark is valid, and it is always used on his plate referred to. To cover the trade-mark with a paper label leaving most of the plate well known to bear complainant's trade-mark, uncovered, informs every one familiar with complainant's goods that it is a Prest-o-Lite tank presumably filled with Prest-o-Lite gas. Purchasers and users are not informed to the contrary. It would be easy to say on the label: "This refilled tank contains acetylene gas made by Avery Lighting Company, and not Prest-o-Lite gas."

I think this case is covered in principle by the following: *Pontefact v. Isenberger* (C. C.) 106 Fed. 499 (defendant restrained from refilling plaintiff's barrels carrying the trademark "Golden Wedding" applied to whisky); *Van Hoboken v. Mohns & Kaltenbach* (C. C.) 112 Fed. 528 (defendants restrained from refilling with gin, and selling, bottles stamped with plaintiff's monogram trade-mark, firm name, and address); *Evans v. Von Laer* (C. C.) 32 Fed. 153 (defendant enjoined from selling lime juice in bottles stamped with complainant's name, both parties being dealers in lime juice); *Hostetter Co. v. Martinoni* (C. C.) 110 Fed. 524 (defendant enjoined from sell-

ing bitters in a demijohn marked H. Bitters and in Hostetter Bitters bottles, complainant having exclusive right to name "Hostetter."). See, also, *Hostetter Co. v. Sommers* (C. C.) 84 Fed. 333, per Townsend, D. J.

I have not gone extensively into the numerous affidavits or the numerous decided cases.

The complainant is entitled to a preliminary injunction restraining the defendant from selling or passing off to its customers or the trade any of these "Prest-o-Lite gas tanks" filled with acetylene gas, unless it shall remove therefrom the metal engraved plate thereon, or completely erase the words and figures thereon, and place on same a plainly printed label stating that it does not contain gas and acetone made by the Prest-o-Lite Company.

So ordered.

§44. *What Misleads Is a Question of Fact.*—As a matter of business experience, are purchasers actually so unwary as Judge Ray seems to assume in the above case? Is it not rather that they are indifferent as to whether they get the one product or the other? A great deal, of course, depends upon the kind of commodity considered and the circumstances under which it is generally sold. Furthermore the standard of business honesty varies in different times and places, and with it the impression that the public is likely to carry away from a label or advertisement. Until comparatively recently, advertising carried with it in the minds of many readers the impression that it was "only advertising." That is to say, due allowance was made for dealers' puffing. Under the influence of some of the leading publication houses in this country, a rigorous censorship on advertising matter has become the practice of most magazines and even newspapers. The standard of business honesty in advertising has accordingly changed and with it the impression conveyed to the public. That courts have taken cognizance of this development will appear when we come to consider the application of the law of fraud and misrepresentations.

§45. *Unfair Competition by Libel and Other Tortious Means.*—Unfair competition frequently assumes other guises than merely misrepresenting the origin of commodities to the public. There is, for example, the ghastly humor of the under-

taker who sent his rival's card to the husband of a dying woman, with the suggestion that satisfaction was guaranteed. *Hughes v. Samuels Bros.* (1916), 179 Iowa, 1077. (The Court deals with these words, though, on their face complimentary, as a libel, which indeed they were, and actionable without special proof of damage because tending to injure the plaintiff's business.) Again there is the deliberate stealing of news from a rival news agency involved in *International News Service v. The Associated Press* (1918), 248 U. S. 215. *Cf.* further Stevens, *Unfair Methods of Competition and Their Prevention,* 63 An Am. Aca. of Soc. and Pol. Sci. 37. A kind of unfair competition that is happily almost obsolete for business rather than legal reasons is the disparaging or "knocking" of a competitor's goods, illustrated in the following case. In this connection two California statutes are interesting, one providing for the revocation of an insurance agent's license for misrepresenting a competitor's business (St. 1919, Ch. 607), and the other making a similar provision with reference to brokers (St. 1919, Ch. 547).

§46 *HOLMES v. CLISBY.*

Georgia Supreme Court, 1903. [118 *Ga.* 820.]

[Action for libel brought by a merchant who had advertised first quality genuine Queen Quality shoes at a reduced price, whereupon the following publication appeared:]

"LADIES OF MACON. QUEEN QUALITY.

"We hereby give notice that the firm of Clisby & McKay is our only authorized agent in Macon for the sale of genuine QUEEN QUALITY shoes under our guarantee. Our damaged shoes we sell to certain dealers under an agreement that they shall be sold as imperfect goods; as we are not willing that damaged or second quality shoes of our make shall be offered to the public as first quality, even when the damage is not apparent to the eye. Those who buy Queen Quality shoes of other dealers than those designated by us as our authorized agents will have only themselves to blame for any disappointment or loss that may ensue.

"Thomas G. Plant Co."

COBB, J.: . . . "A libel is a false and malicious defamation of another, expressed in print, or writing, or pictures, or signs, tending to injure the reputation of an individual, and exposing him to public hatred, contempt, or ridicule." Civil Code, §3832. A publication coming within this definition is actionable without an averment of special damage. But a publication which has the effect merely of disparaging a tradesman's goods is not actionable without an allegation of special damage. *Boynton v. Shaw Stocking Co.* (Mass.), 15 N. E. 507; *Boynton v. Remington,* 3 Allen, 397; *Dooling v. Budget Publishing Co.* (Mass.) 59 Am. Rep. 83. The controlling question, therefore, to be determined in such a case as the one now under consideration is whether the publication has a tendency to injure the reputation of the person against whom it is directed and expose him to public hatred, contempt, or ridicule, or whether its effect is simply to disparage goods which he is offering for sale. It is possible that a publication may have both of these effects. *Dooling v. Budget Publishing Co., supra.* And whenever a publication is susceptible of two constructions, one of which would make it libelous and the other not, it is for the jury to say whether the words are in fact libelous. *Beazley v. Reid,* 68 Ga. 380; *Colvard v. Black,* 110 Ga. 646. The plaintiff can not by innuendo draw from a writing a conclusion not justified by the language used; but it is competent for the plaintiff to explain in this way an ambiguous publication, to point out the intention of the author, and to show wherein the effect of the language was to injure his reputation. *Park v. Insurance Co.,* 51 Ga. 510. And the rule is that a publication must be construed in the light of all the attending circumstances, the cause and occasion of the publication, and all other extraneous matters which will tend to explain the allusion or point out the person in question. *Colvard v. Black,* 110 Ga. 647. Words harmless in themselves may become libelous when the circumstances under which they are published are such as to convey a covert meaning to the reader reflecting injuriously upon the reputation of the person to whom they refer. These circumstances, as well as the existence of a motive for using the words in a covert sense, should be considered in determining whether they are libelous, when applied to the person to whom they expressly refer or to whom they must have been intended to refer. The publication under consideration in the present case was manifestly in disparagement of the shoes which the plaintiff was offering for sale, but it was more than this. When all the circumstances as detailed in the petition are taken into view, a jury would be authorized to say that the author intended, and would be so understood by

those familiar with the circumstances, to reflect upon the reputation of the plaintiff and expose him to public hatred and contempt. A construction of the words in the light of these circumstances, which would make the publication charge, in effect, that the plaintiff was a cheat and was endeavoring to palm off on the public damaged goods for perfect goods, and that, too, imperfect goods which contained merely latent defects, would be neither forced nor strained.

That the publication was intended to refer to the plaintiff cannot, in view of the allegations of the petition, admit of doubt. If one reading the publication knew that it referred to the plaintiff, knew that he was selling Queen Quality shoes at a reduced price, the inference was irresistible that he was selling damaged goods, and when this is coupled with the further fact that the plaintiff had advertised that his goods were perfect and undamaged, the conclusion is well warranted that the author of the publication intended to charge that the plaintiff's advertisement was false, and that in inserting the advertisement he was guilty of a deliberate falsehood and intended thereby to cheat and defraud the ladies of Macon who were likely to become his customers. Such a publication, in our opinion, exceeded the bounds of legitimate competition. It is right and proper for tradesmen to puff their own goods to the disparagement of those of others, but they must not allow their zeal to betray them into an attack upon the personal reputation of their competitors for honesty and integrity. It is not always easy to draw the line between what would be considered legitimate competition and a libelous publication, but the writing complained of in this case was, in our judgment, susceptible of the construction which the plaintiff put upon it. The case of *Behre v. National Cash Register Company,* 100 Ga. 213, is closely in point. There the publication charged simply that the plaintiff was no longer connected with the National Cash Register Company, and that any contracts made by him for the company would be void. The court held that these words were susceptible of the construction which the plaintiff put upon them, to the effect that he was endeavoring to represent a company which he had no authority to represent, and was in this manner endeavoring to defraud and cheat the public. There was no allegation of special damage in that case, and the decision was put distinctly on the ground that the publication, construed in the light of the innuendoes laid in the petition, constituted a libel, for which an action for general damages would lie. The defendant in error relied upon the cases of *Boynton v. Shaw Stocking Company,* and *Boynton v. Remington,* both of which are cited above. In each of those cases

the publication complained of was held to be merely in disparagement of the plaintiff's goods, and not a libel upon his reputation. It is to be admitted that these decisions are very closely in point. There are, of course, some points of difference between the publications in those cases and the one now under consideration, but these differences are perhaps immaterial. Notwithstanding the very high respect which we entertain for the distinguished court which rendered those decisions, we are unwilling to allow them to influence us to make a decision which in our judgment would be unsound.

§47. *Justification in Cases Involving Interference With Trade or Calling.—Note in* 3 *Va. L. Rev.* 385. "The right to carry on a lawful business or to exercise a legitimate calling without unlawful interference is universally recognized. Modern developments of the law sustain the proposition that intentional interference with another's business or occupation is actionable if no justification is established.[1] The theory of justification in such cases consists in compromise between conflicting rights by estimating in the light of public policy and social advantage the limits within which the rights of one person may be restricted in order to allow another to exercise an opposing interest.[2] It is plain from its indefinite nature that no statement of what constitutes justification applicable to all cases may accurately be proposed. In general to justify an intentional injury to a lawful trade it must appear that the act complained of was otherwise lawful, that the means employed were not illegal, and that the object sought tended to the advancement and interest

[1]*Huskie v. Griffin*, 75 N. H. 345, 74 Atl. 595, 27 L. R. A. (N. S.) 966; *Willner v. Silverman*, 109 Md. 341, 71 Atl. 962; *Wesley v. Native Lumber Co.*, 97 Miss. 814, 53 South. 346. But see Pollock, *Torts*, 8th ed. p. 346.

[2]In 28 Law Quart. Rev. 67, it is said: "The theory of justification consists in a proper adjustment and compromise between the two competing rights that are equally protected in law. It has been already observed that the enjoyment by a particular individual of the right of freedom, as to how he should bestow his capital and labor, is not absolute, but qualified by the existence of equal rights in the other members, to such an extent, as to be made compatible with an equally free enjoyment of these rights by the rest of the community. In fact, every case of justification reduces itself to the question, how far the rights of an individual can be so circumscribed in accordance with a general law of freedom, as to leave an equal scope for the free enjoyment of competing rights of his fellow men."

of the doer.[3] Interference with contract relations in general is actionable.[4] It is necessary that the wrong-doer have knowledge of the existence of the contract and that he causes its breach in bad faith. Justification for such acts may be shown by setting up an equal or superior right in the person causing the breach.[5] A third person is not liable for inducing another to terminate a contract of partnership which was terminable at will.[6]

The chief source of justification in adjusting injuries to business or calling is in the right of competition. Business competition carried on in a lawful manner is a complete defense to whatever injuries are accomplished by lawfully pursuing a competing business.[7] So in the absence of unlawful means and where no breach of contract is procured it is justifiable for a competitor to induce the customers of another to transfer their trade to him.[8] This right to compete is not limited by the damage done and fair competition lawfully conducted may completely drive a rival out of business with no liability attaching to the successful competitor.[9]

However, the competition must be genuine and not pretended. It has been held in a few cases which have considered the question that a simulated competition carried on with the express purpose of injuring another's business is actionable if injury results.[10] It is not necessary that every particular transaction in trade be conducted for the profit of the trader provided that his business in general assumes the aspect of real competition.[11]

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[3] *Hutton v. Watters* (Tenn.), 179 S. W. 134 (principal case).

[4] *Wheeler-Stenzel Co. v. American Window Glass Co.*, 202 Mass. 471.

[5] See note 7, *infra*. See also *Berry v. Donovan*, 188 Mass. 353, 74 N. E. 603.

[6] *McGuire v. Gerstley*, 204 U. S. 489.

[7] *Lewis v. Hine Hodge Lumber Co.*, 121 La. 658, 46 South. 685; *Mogul S. S. Co. v. McGregor*, L. R. 23 Q. B. Div. 598.

[8] *Citizens' Light, Heat & Power Co. v. Montgomery Light & Water Power Co.*, 171 Fed. 553.

[9] *Mogul S. S. Co. v. McGregor, supra; Lough v. Outerbridge*, 143 N. Y. 271, 38 N. E. 292, 25 L. R. A. 674.

[10] *Tuttle v. Buck*, 107 Minn. 145, 119 N. W. 946, 22 L. R. A. (N. S.) 599, 131 Am. St. Rep. 446, 16 Ann. Cas. 807; *Boggs v. Duncan-Sebell Furniture Co.*, 163 Iowa 106, 143 N. W. 482, L. R. A. 1915B, 1196. See *Dunshee v. Standard Oil Co.*, 152 Iowa 623, 132 N. W. 371, 36 L. R. A. (N. S.) 263.

[11] *Mogul S. S. Co. v. McGregor, supra; Lough v. Outerbridge, supra.*

Another form of competition which is advanced as matter of justification is that involved in labor controversies. The American decisions have not allowed labor competition the high place which competition in trade or commerce has been conceded.[12] In boycotts carried on by labor unions the means, though otherwise lawful, create an intense form of coercion which renders them actionable and the methods used and the continuance of boycotts may be enjoined in the proper cases.[13] The fact that the boycott was conducted for the benefit and advancement of the union will not avail to justify it.[14]

It is clear that the adjustment of the wages or the reduction of the hours of labor or any other change for the benefit of the employees attempted by a peaceable strike will not render the employees or the union which they represent liable to the employer even if he is injured.[15] Difficulty arises when the effect of a strike is to cause damage to persons other than the employers. Difference of opinion prevails in the courts on the question of the liability of labor unions when they institute strikes to procure the discharge of non-union men or as it is commonly called—to secure the closed shop.

The most widely held view seems to be that such strikes or similar transactions with employers, though conducted in a lawful manner, create a right of action against the union or union agents when the non-union men are deprived of their employment.[16] It is considered that the benefit or advancement of the union by such acts does not create in its members a self-interest which is sufficient to justify the injury to the non-union men who are deprived of their occupation. The reason advanced by the courts upholding the opposite view is that such strikes tend to unify and strengthen the organization of labor, thereby creating

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[12]See 1 Street, *Foundations of Legal Liability*, p. 361.

[13]*Casey v. Cincinnati Typographical Union*, 45 Fed. 135; *Beck v. Railway Teamsters' Protective Union*, 118 Mich. 497, 77 N. W. 13, 74 Am. St. Rep. 421, 42 L. R. A. 407.

[14]See *Casey v. Cincinnati Typographical Union*, 45 Fed. 135, 143.

[15]*Karges Furniture Co. v. Amalgamated Woodworkers' Local Union, No.* 131, 165 Ind. 421, 75 N. E. 877, 2 L. R. A. (N. S.) 788; *Jetton-Dekle Lumber Co. v. Mather*, 53 Fla. 969, 43 South. 590.

[16]*Berry v. Donovan, supra; Erdman v. Mitchell*, 207 Pa. 79, 56 Atl. 327; *Lucke v. Clothing Cutters' Assembly*, 77 Md. 396, 26 Atl. 505; *Folsom v. Lewis*, 208 Mass. 336, 94 N. E. 316.

a more effectual means to maintain successfully their rights in controversy with the employers.[17]

Where strike was threatened to procure the discharge of a workman merely because he was 'obnoxious' or 'distasteful' to his fellow workmen, the discharged employee was allowed to recover damages from such employees.[18] But where the discharged employee's system of work is unfair or prejudicial to the other employees a strike to compel his dismissal was considered justifiable.[19]

Where an employer notified his employees not to trade with plaintiff on pain of dismissal the resulting injury to plaintiff's business is an actionable wrong.[20] However, where defendant operated an establishment similar to plaintiff's in connection with his main business such conduct was held justifiable as fair competition and no recovery was had for damages caused thereby.[21]

It has been advanced in a few cases that friendly advice and good motives constitute sufficient justification in cases of interference with trade or calling. An English case expressly ruled that no such justification existed.[22] But in this country though there is little consideration of it in the cases, it has been indicated that liability will not attach where the interference is by way of friendly or neighborly advice, honestly given.[23]

In the recent case of *Hutton v. Watters* (Tenn.), 179 S. W. 134, it is held that intentional interference with the business of plaintiff by preventing her from obtaining boarders and by

[17]*Pemp v. Division No.* 241, 255 Ill. 213, 99 N. E. 389; *National Protective Ass'n v. Cummings*, 170 N. Y. 315, 63 N. E. 369. See dissenting opinion of Justice Holmes in *Plant v. Wood*, 176 Mass. 492, 57 N. E. 1011.

[18]*Bausbach v. Reiff*, 244 Pa. 559, 91 Atl. 224; *DeMinco v. Craig*, 207 Mass. 593, 94 N. E. 317.

[19]*Minasian v. Osborne*, 210 Mass. 250, 96 N. E. 1036.

[20]*Graham v. St. Charles Street R. R. Co.*, 47 La. Ann. 214, 16 South. 806, 27 L. R. A. 416, 49 Am. St. Rep. 366; *Wesley v. Native Lumber Co.*, *supra*. But see *Gott v. Berea College*, 156 Ky. 376, 161 S. W. 204, 51 L. R. A. (N. S.) 17.

[21]*Lewis v. Hine-Hodge Lumber Co.*, *supra*.

[22]*South Wales Miners' Federation v. Glamorgan Coal Co.* (1905), A. C. 239.

[23]See *Walker v. Cronin*, 107 Mass. 555; *West Virginia Transportation Co. v. Standard Oil Co.*, 50 W. Va. 611, 40 S. E. 591, 88 Am. St. Rep. 895, 56 L. R. A. 804.

depriving her of boarders by threats and other means not unlawful in themselves is actionable where the circumstances show no justification for defendant's acts. The court in this case criticizes *Payne v. Railroad Co.,*[24] and expressly overrules it in so far as it is in conflict with the opinion.

It is repeated that no satisfactory rule can be put forward to cover all cases where justification is the deciding element. These notes attempt only to set out what seem to be the main principles and to point to a few instances of their application."

§48 *LAWLOR v. LOEWE.*

Supreme Court of United States, 1915. [235 *U. S.* 522.]

HOLMES, J.: This is an action under the act of July 2, 1890, chap. 647, §7, 26 Stat. at L. 209, 210, Comp. Stat. 1913, §§8820, 8829, for a combination and conspiracy in restraint of commerce among the states, specifically directed against the plaintiffs (defendants in error), among others, and effectively carried out with the infliction of great damage. The declaration was held good on demurrer in 208 U. S. 274, 52 L. ed. 488, 13 Ann. Cas. 815, where it will be found set forth at length. The substance of the charge is that the plaintiffs were hat manufacturers who employed non-union labor; that the defendants were members of the United Hatters of North America and also of the American Federation of Labor; that in pursuance of a general scheme to unionize the labor employed by manufacturers of fur hats (a purpose previously made effective against all but a few manufacturers), the defendants and other members of the United Hatters caused the American Federation of Labor to declare a boycott against the plaintiff and against all hats sold by the plaintiffs to dealers in other states, and against dealers who should deal in them; and that they carried out their plan with such success that they have restrained or destroyed the plaintiff's commerce with other states. The case now has been tried, the plaintiffs have got a verdict, and the judgment of the district court has been affirmed by the circuit court of appeals. 126 C. C. A. 445.

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[24] 13 Lea (Tenn.) 507, 49 Am. Rep. 666. In this case the plaintiff, a storekeeper, had incurred the ill will of the defendant railroad company. The defendant through no reason of benefit to the company but on account of the altercation with the plaintiff forbade its employees to deal with the plaintiff and threatened to discharge those who continued to do so. It was held that no action could be brought for resulting injury to the plaintiff.

The grounds for discussion under the statute that were not cut away by the decision upon the demurrer have been narrowed still further since the trial by the case of *Eastern States Retail Lumber Dealers' Asso. v. United States,* 234 U. S. 600, 58 L. ed. 1490. Whatever may be the law otherwise, that case establishes that, irrespective of compulsion or even agreement to observe its intimation, the circulation of a list of "unfair dealers," manifestly intended to put the ban upon those whose names appear therein, among an important body of possible customers, combined with a view to joint action and in anticipation of such reports, is within the prohibitions of the Sherman Act if it is intended to restrain and restrains commerce among the states.

It requires more than the blindness of justice not to see that many branches of the United Hatters and the Federation of Labor, to both of which the defendants belonged, in pursuance of a plan emanating from headquarters, made use of such lists and of the primary and secondary boycott in their effort to subdue the plaintiffs to their demands. The union label was used and a strike of the plaintiffs' employees was ordered and carried out to the same end, and the purpose to break up the plaintiffs' commerce affected the quality of the acts. *Loewe v. Lawlor,* 208 U. S. 274, 299, 52 L. ed. 488, 500, 13 Ann. Cas. 815. We agree with the circuit court of appeals that a combination and conspiracy forbidden by the statute were proved, and that the question is narrowed to the responsibility of the defendants for what was done by the sanction and procurement of the societies above named.

The court in substance instructed the jury that if these members paid their dues and continued to delegate authority to their officers unlawfully to interfere with the plaintiffs' interstate commerce in such circumstances that they knew or ought to have known, and such officers were warranted in the belief that they were acting in the matters within their delegated authority, then such members were jointly liable, and no others. It seems to us that this instruction sufficiently guarded the defendants' rights, and that the defendants got all that they were entitled to ask in not being held chargeable with knowledge as matter of law. It is a tax on credulity to ask anyone to believe that members of labor unions at that time did not know that the primary and secondary boycott and the use of the "We don't patronize" or "Unfair" list were means expected to be employed in the effort to unionize shops. Very possibly they were thought to be lawful. See *Gompers v. United States,* 233 U. S. 604, 58 L. ed. 1115. By the constitution of the United Hatters the directors are to use "all the means in their power" to bring shops "not under

our jurisdiction" "into the trade." The by-laws provide a separate fund to be kept for strikes, lockouts, and agitation for the union label. Members are forbidden to sell non-union hats. The Federation of Labor, with which the Hatters were affiliated, had organization of labor for one of its objects, helped affiliated unions in trade disputes, and to that end, before the present trouble, had provided in its constitution for prosecuting and had prosecuted many what it called legal boycotts. Their conduct in this and former cases was made public especially among the members, in every possible way. If the words of the documents, on their face and without explanation, did not authorize what was done, the evidence of what was done publicly and habitually showed their meaning and how they were interpreted. The jury could not but find that by the usage of the unions the acts complained of were authorized, and authorized without regard to their interference with commerce among the states. We think it unnecessary to repeat the evidence of the publicity of this particular struggle in the common newspapers and union prints, evidence that made it almost inconceivable that the defendants, all living in the neighborhood of the plaintiffs, did not know what was done in the specific case. If they did not know that, they were bound to know the constitution of their societies, and at least well might be found to have known how the words of those constitutions had been construed in act.

It is suggested that injustice was done by the judge speaking of "proof" that, in carrying out the object of the associations, unlawful means had been used with their approval. The judge cautioned the jury with special care not to take their view of what had been proved from him, going even further than he need have gone. *Graham v. United States*, 231 U. S. 474, 480, 58 L. ed. 319, 324. But the context showed plainly that proof was used here in a popular way for evidence, and must have been understood in that sense.

Damages accruing since the action began were allowed, but only such as were the consequence of acts done before and constituting part of the cause of action declared on. This was correct. *New York, L. E. & W. R. Co. v. Estill,* 147 U. S. 591, 615, 616, 37 L. ed. 292, 304. We shall not discuss the objections to evidence separately and in detail, as we find no error requiring it. The introduction of newspapers, etc., was proper in large part to show publicity in places and directions where the facts were likely to be brought home to the defendants, and also to prove an intended and detrimental consequence of the principal acts, not to speak of other grounds. The reasons given by customers for ceasing to deal with sellers of the Loewe hats, includ-

ing letters from dealers to Loewe & Co., were admissible. 3 Wigmore, *Ev.* §1729 (2). We need not repeat or add to what was said by the circuit court of appeals with regard to evidence of the payment of dues after this suit was begun. And, in short, neither the argument nor the perusal of the voluminous brief for the plaintiffs in error shows that they suffered any injustice, or that there was any error requiring the judgment to be reversed.

Judgment affirmed.

CHAPTER VI

THE DUTY TO SERVE THE PUBLIC

§49 *ANONYMOUS.*

[*Y. B. Trinity,* 21 *Hen. VI.* 55, *pl.* 12 (1443).]

PASTON, J.: If I come riding along the highway to a town where a smith lives who has sufficient stuff to shoe my horse, supposing it has lost a shoe, and I request him at a proper time to shoe it and offer him enough for his labor and he refuses so that my horse is later lost for want of shoes, because of his default, I say in such event I shall have action of trespass on the case.

§50. *The "Justum Pretium" in the Middle Ages.*—The doctrine announced here is, of course, no longer law. The ordinary business man is entirely free to deal with members of the public or refuse to do so as he sees fit. "It is a part of a man's civil rights that he be at liberty to refuse business relations with any person whomsoever, whether the refusal rests upon reason, or is the result of whim, caprice, prejudice, or malice." Cooley on *Torts,* p. 278. Quoted in *Great Atlantic and Pacific Tea Company v. Cream of Wheat Company,* 227 Fed. Reporter, 46, 48. There is, however, a large and growing list of exceptions among public utilities and other specially regulated or licensed business and professions, as illustrated in the following cases. A closely related question is that of the limitation of one's rights to set his own price on his wares or services. The idea of a *justum pretium* was generally accepted in the Middle Ages, that is to say, a just price established by custom or statute rather than by the will of the seller controlled only by economic exigencies.[1]

In the nineteenth century there was scarcely a vestige of it,

[1] *E. g.* 1 Statutes of the Realm 199 (fixing the prices of bread and beer in 1256); 23 Ed. III, and 25 Ed. III (Statutes of Laborers, 1349 and 1351); 23 Ed. III c. 6 (prices of victuals, 1349); 25 Ed. III c. 4 (prices of shoes, 1351.)

so complete was the dominance in law of the school of Adam Smith. Its revival today not only by enlarging the list of public utilities but by the general demand of laws against "profiteering," is significant of the tendency that has been aptly described as the "socialization of the law."[2]

§51. *McDUFFEE v. THE PORTLAND & ROCHESTER RAILROAD.*

Supreme Judicial Court of New Hampshire, 1873.
[52 *N. H.* 430.]

DOE, J. I.: A common carrier is a public carrier. He engages in a public employment, takes upon himself a public duty, and exercises a sort of public office. *Sanford v. R. Co.,* 24 Pa. St. 378, 381; *N. J. S. N. Co. v. Merchants' Bank,* 6 How. 344, 382; *Shelden v. Robinson,* 7 N. H. 157, 163, 164; *Gray v. Jackson,* 51 N. H. 9, 10; *Ansell v. Waterhouse,* 2 Chitty 1, 4; *Hollister v. Nowlen,* 19 Wen. 234, 239. He is under a legal obligation; others have a corresponding legal right. His duty being public, the correlative right is public. The public right is a common right, and a common right signifies a reasonably equal right. "There are certain cases, in which, if individuals dedicate their personal services, or the temporary use of their property, to the public, the law will impose certain duties upon them, and regulate their proceedings to a certain extent. Thus, a common carrier is bound by law, if he have conveniences for the purpose, to carry for a reasonable compensation." *Olcott v. Banfill,* 4 N. H. 537, 546. "He [the common carrier] holds a sort of official relation to the public. He is bound to carry at reasonable rates such commodities as are in his line of business, for all persons to offer them, as early as his means will allow. He cannot refuse to carry a proper article, tendered to him at

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[2]*Cf.* a note on Congressional Rent Legislation for the District of Columbia (Pub. Laws, 66th Cong., First Session, No. 63, H. R. 8624, Title II, approved Oct. 22, 1919) in which the applicability of this War Power legislation to peace conditions is discussed, 20 Col. L. Rev. 109. On "fair prices" see also H. R. hearings, 13305, 63rd Congress, Second and Third Sessions, and 13568, 64th Congress First and Second Sessions. Minimum wage legislation is a type of price regulation. On experiments in foreign countries compare Wilkinson, *State Regulation of Prices in Australia,* Melbourne, 1917. During the World War a very extensive price regulation was practised by the government agencies entrusted with the distribution and conservation of food and other necessaries. On legislation and litigation connected with Rent Regulation see article by Walter F. Dodd and Carl H. Zeiss in Journal issued by Am. Bar Assn., Jan., 1921, p. 5. See also note in 34 Harv. L. R. 426.

a suitable time and place, on the offer of the usual reasonable compensation. Story on *Bailments,* §508; *Riley v. Horne,* 5 Bing. 217, 224; *Bennett v. Dutton,* 10 N. H. 486. When he undertakes the business of a common carrier, he assumes this relation to the public, and he is not at liberty to decline the duties and responsibilities of his place, as they are defined and fixed by law.'' *Moses v. B. & M. R. R.,* 24 N. H. 71, 88, 89. On this ground, it was held, in that case, that a common carrier could not, by public notice, discharge himself from the legal responsibility pertaining to his office, or from performing his public duty in the way and on the terms prescribed by law.

''The very definition of a common carrier excludes the idea of the right to grant monopolies, or to give special and unequal preferences. It implies indifference as to whom they may serve, and an equal readiness to serve all who may apply, and in the order of their application.'' *N. E. Express Co. v. M. C. R. R. Co.,* 57 Me. 188, 196. A common carrier of passengers cannot exercise an unreasonable discrimination in carrying one and refusing to carry another. *Bennett v. Dutton,* 10 N. H. 481. A common carrier of freight cannot exercise an unreasonable discrimination in carrying for one and refusing to carry for another. He may be a common carrier of one kind of property, and not of another; but, as to goods of which he is a common carrier, he cannot discriminate unreasonably against any individual in the performance of the public duty which he assumed when he engaged in the occupation of carrying for all. His service would not be public, if, out of the persons and things in his line of business, he could abitrarily select whom and what he would carry. Such a power of arbitrary selection would destroy the public character of his employment, and the rights which the public acquired when he volunteered in the public service of common carrier transportation. With such a power, he would be a carrier,—a special, private carrier, but not a common, public one. From the public service, —which he entered of his own accord,—he may retire, ceasing to be a common carrier, with or without the public consent, according to the law applicable to his case; but, as long as he remains in the service, he must perform duties appertaining to it. . . .

§52. *From Edward A. Adler. Business Jurisprudence,* 28 *Harv. Law Rev.* 133, 156.—''The disappearance of this conception [that the business man has no legal right to discriminate among members of the public] from our law in the case of all

ordinary businesses and its retention in the case of carriers is to be explained partly by economic and social changes and partly by judicial misinterpretation of the early cases. That the disappearance did not take place suddenly is evidenced by the frequently cited cases of *Gisbourn v. Hurst* (1710), 1 Salk. 249; *Lane v. Cotton* (1701), 12 Mod. 472, and *Coggs v. Bernard* (1703), 2 Ld. Raymond 909, decided at the beginning of the eighteenth century, which still assert the ancient doctrine. But with the inventions of Arkwright, the writings of Adam Smith, and the spread of the idea of *free* trade, a great change took place in business conditions toward the close of the eighteenth century. In ordinary trades there ceased to be any need for a distinction between the common and the private exercise of a trade.''

§52a. *Public and Private Business.*—The basis of distinction between common carriers and other business men, suggested in the McDuffee case, is that ''common carrier'' means ''public carrier.'' This is a misconception of the original meaning of the expression, a bit of folk-etymology, from which important deductions have been made by courts, none the less. In the old expressions, common merchant, common marshal, common schoolmaster, common surgeon, common shaver, common bellman, common maker and vendor, common hoyman, common kidder, common scold, common railer and brawler, common thief, the word ''common'' meant habitual, regular—doing a thing frequently or commonly. Thus the opposite of a common carrier is not a private carrier, but a special carrier; that is one who carries goods on a particular occasion. In course of time, this sense of the word was lost in English and the expression ''common carrier'' came to suggest a public carrier in the sense of one who served the public. The argument drawn from this understanding of the term, that such a carrier must serve all members of the public alike, was an afterthought. A similar afterthought has since been said to justify and explain the exercise of the right of eminent domain on behalf of a common carrier, and other peculiar rights and privileges, as well as peculiar duties and liabilities. The term ''common carrier'' came to have the con-

notation of a carrier engaged in a public service, that is, a service primarily due *from* the state (compare Ranney, J. in *Giesy v. Railroad Co.*, 4 Ohio State, 324).[1] Needless to say, no such socialistic view colored the word ''common'' in the English law of the 1300's. Compare 23 Jour. of Pol. Econ., p. 554, note 1.

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[1]It would logically follow from this concept of the carrier's calling that he is an agent of the state. In a paper read before the National Association of Railway Commissioners, in 1913, by Max Thelen, commissioner and attorney of the California Railroad Commission, on "a just and scientific basis for the establishment of public-utility rates with particular attention to land values" this view, now widely held as an inarticulate major premise, is eloquently expressed. "The fundamental relationship existing between the public and its public utilities is that of principal and agent. Out of this relationship logically should grow the proper basis for determining the rates which a public utility is entitled to charge. The state has the right to do for the public whatever is demanded for the public welfare, including the establishment and operation of enterprises of a public utility character. . . . I shall now consider the bearing of this relationship on the problem of the proper basis for rate fixing. It is a well-established principle in agency that an agent acting within the scope of his authority is entitled to be reimbursed for the money which he honestly and judiciously expends for the benefit and account of the principal, together with a proper compensation for his services. As a general rule it is a breach of good faith and of loyalty to the principal for an agent to deal with the subject-matter of the agency so as to make a profit out of it for himself in excess of his lawful compensation. If such profit is made, the agent may be held as a trustee and may be compelled to account to his principal for all profits and advantages acquired by him out of the relationship. If the agent acquires title to property in his own name as part of the agency, he will be deemed to hold this title for his principal. If A is the principal and B the agent, and A, for the purpose of enabling B to carry out the agency, deeds property to B, B cannot later contend that he can hold the property for himself. He holds it for his principal. Likewise, if B, in the course of his agency, acquires title to property from any source, and that property thereafter increases in value, he cannot lay claim to keep the increase for himself. In each of the above cases the agent holds the property for the principal, and must account to the principal for it. Applying these principles to the relationship between the public and the public utilities, it seems clear that the public utilities are entitled to a reasonable return upon such money as they honestly and wisely expend for the public, but that they should not be allowed a return on the increased value of the property used in the agency. If the agent has expended money dishonestly or has expended it injudiciously, he is not entitled to a return thereon. On the other hand, if he has acted honestly and wisely, and it thereafter becomes possible to acquire more cheaply property which he has purchased in the agency, or to secure at a lesser expense labor or material used therein, the agent should not be compelled to suffer the loss, but should be entitled to a return on the money honestly and wisely spent by him in pursuance of the agency." Quoted in 48 L. R. A. (N. S.), 1199.

What, then, is the historical basis of the distinction between a common carrier (with whom was the common innkeeper, and for a long time the common smith) and most persons engaged in business with reference to discrimination among members of the public? The answer is to be sought in the tendency, which culminated in the nineteenth century, to deny all manner of liability unless based directly on the exercise of one's free will or on his fault; that is to say, contract and tort rather than status or condition or position in life were considered an adequate basis of the law obligations. Freedom of contract implied the converse, freedom to refuse to contract. This tendency explains the general rule. What remains to be explained, therefore, is the exception in the case of the common carrier and common innkeeper. May not the fact that these and the common smith, who was the last of the common tradesmen to desert their company, preferred to rely upon their liens rather than special contracts have something to do with the perpetuation of a fair non-contractual price among them? Professor Ames has shown that, for a long time, a lien could be claimed only for a fair price and that in the case of a contractual stipulation, no lien existed.[2] The carrier, innkeeper and smith dealing with the traveling public were unlike the common tailor who dealt with his fellow townsmen, though the court in *Nicholls v. More* (1661), 1 Siderfin 36, could see no difference. There was none in law. There was a great difference in business between relying on the credit of a man known to you and on the security furnished by the goods of a stranger from another part of the world. In course of time, the smith ceased to be included among those serving the traveling public; probably because for ordinary travel stage-coaches filled the place of travel on horseback. Most of us would be in favor, now that another change in inter-community travel has taken place, to subject the common garage-owner to the same limitations under which the common smith once suffered or throve.

Thus the modern considerations based on the monopolies of railroads, the extreme dependence of society as it is organized

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[2] *Lectures on Legal History,* pp. 157, 158.

today on transportation, the socialistic notion of the scope and nature of state functions and the like, while they may furnish excellent reasons for continuing the rule of non-discrimination in certain businesses and even for extending it, are, so far as the older law is concerned, mere afterthoughts and anachronisms.

For a discussion of the history of the so-called public occupations, see the first pages of Beale, *Innkeepers and Hotels,* (1906); Beale and Wyman, *Railroad Rate Regulation,* 2d edition (1915); C. K. Burdick, *The Origin of the Peculiar Duties of Public Service Companies,* 11 Columbia Law Rev. 514.

§53 *THE GREAT ATLANTIC AND PACIFIC TEA COMPANY v. CREAM OF WHEAT COMPANY*

U. S. District Court, Southern District of New York, 1915. [224 *Fed.* 566.][1]

HOUGH, D. J.: Although the application is for relief *pendente lite* only, all the essential facts are set forth with clearness, and without contradiction upon any material point. The novelty of the litigation is such, that a careful statement of what these facts are, is more than excusable, for upon them will depend conclusions of law, toward whose final settlement the action of this court is but a preliminary. . . .

The business of the defendant is what is commonly called the "manufacture" and sale of the food product known as "Cream of Wheat." Manufacturing is a word of such wide and loose meaning, as to include the preparation by art of any finished product from raw material; but more accurately descriptive words for defendant's business are, selection and cleansing of the by-product of a true manufacture, viz.: flour-making.

"Middlings" are the coarse flour and fine bran separated by bolting from fine flour and coarse bran. These middlings defendant "selects," selection depending upon the grade and kind of wheat used by the miller—and then purifies or cleanses such selection. The result is cream of wheat, which is no more than purified middlings. It is not patented, any one can make it who can get middlings, and the amount of that material annually required by the business of the defendant, is less than one per

[1]Affirmed in the Circuit of Appeals, Second Circuit, 1915, 141 C. C. A. 594; 227 Fed. 46.

cent. of the amount thereof produced in the same period by the millers of the United States.

Obviously defendant does not, and cannot control, nor indeed does it seek to control or monopolize, the production of or market for middlings. It naturally wishes to buy its raw material wherever it can procure the same easiest, best and cheapest. Yet it has a monopoly—a perfectly lawful monopoly—in the trade name "Cream of Wheat." By the law of trade-mark and unfair competition, no one but defendant can sell, under the name chosen by defendant, what any one can make and sell under another and non-infringing label. The style and dress, name and package of defendant have been extensively and successfully advertised for eighteen years, until the public has grown accustomed to ask for and get something good to eat under the name "Cream of Wheat," and an identical substance under another name would have to travel the same long hazardous and expensive path, in order to get or create a market.

It is possible to assert that the (say) one per cent. of middlings, which when selected and purified is called "Cream of Wheat," is for legal purposes at all events, a different commodity, a separate thing or entity from all other "middlings." The point is mere dialetic, for all that makes the difference or separates the things is a name; and the substantial truth remains that defendant's business consists in lawfully monopolizing a trade name, and impressing the public with the purity, reliability and uniformity of the very common substance it sells under that cleverly chosen name. The selection of the name was quite as important as the selection of the middlings, when business began, and after so much advertising the name or brand is by long odds the most important element in the business. . . .

It is not worth while to consider whether the facts above shown produce a case under the Sherman Act. If they do, the matter is not much advanced, because under that statute the plaintiff could not bring this action in equity; and if they do not, plaintiff just as firmly asserts its right to relief under the Clayton Act.

I shall therefore follow counsel (none of whom has discussed the applicability of the Sherman Act), and say no more about it.

[Dismissing the Sherman Act (July 2, 1890, 26 St. at L. 209) the Court proceeds to discuss the Clayton Act (Oct. 15, 1914, 38 St. at L. 730), particularly Sec. 2.]

It will show my interpretation of §2, and emphasize any errors of construction, to pick out, sometimes paraphrase, and arrange in order the words of that section deemed applicable to the case in hand, thus: "It is unlawful for a person engaged in

commerce,[2] and in the course of commerce, to discriminate in price between purchasers of commodities,[3] whenever discrimination may substantially lessen competition, or tend to create a monopoly in any line of commerce,[4] but there may be price discrimination on account of quantity of commodity sold; and persons selling goods may still select their own customers in *bona fide* transactions,[5] and not in restraint of trade.

Plaintiff's syllogisms [*sic*] in support of the demand for relief are simple; thus:

(1) Defendant has a monopoly in Cream of Wheat;
(2) Through such monopoly it fixes the re-sale price of that article; therefore
(3) It prevents competition in Cream of Wheat and violates the body of Sec. 2.

Again:

(1) Preventing competition is restraint of trade;
(2) Defendant does prevent competition; therefore
(3) It restrains trade and is not within the exception of Sec. 2.

If the premises of the above logical formulæ are admitted in the sense and to the extent plaintiff asserts or assumes as proper, the conclusions flow as matter of course. A successful answer must deny or avoid the premises; or ascribe to words a scope and meaning at variance with plaintiff's usage.

Taking up *seriatim* the parts of the above propositions: it is true that defendant has a monopoly in Cream of Wheat, but, as heretofore stated, it is a lawful monopoly, ultimately resting on the plain truth that there can be nothing anywhere in the United States lawfully called Cream of Wheat without defendant's consent and approbation. In that substance (if legally it is a distinct substance) defendant has the monopoly of a creator; something which is not and never has been within the prohibition of any law, anti-trust or otherwise.

On the contrary that monopoly is encouraged by patent, trade-mark, and copyright statutes, and the rules of unfair competition. Therefore the implication of plaintiff's premise, that

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[2]Commerce can only mean (as the context shows) interstate or foreign commerce.

[3]That is "commodities" sold by the "person" first named.

[4]"Line of Commerce," this vulgarism is not a term of art, but it must mean trading or dealing in the commodities (or some of them) first above spoken of.

[5]It would have been simpler to say that vendors may select their own *bona fide* customers. I think the intent is to exclude from the exception pretended sales, *e. g.*, consignments to undisclosed agents; and perhaps sales coupled with an attempted condition subsequent.

there is something inherently wrong in defendant's monopoly, is false and misleading.

The minor premise, that defendant *fixes* the re-sale price, is not in my opinion true in point of fact. It would like to fix that price, so far as its minimum is concerned; but *fixing* connotes enforcement; that it cannot accomplish, and since 1913 at all events, the attempt has been abandoned. Let it be assumed that defendant declines business with all who refuse to maintain prices. If such refusal affected a necessity of life, or even a staple article of trade, the matter might be serious, and history might be appealed to for instances of statutory punishment, *e. g.*, the engrossing acts. But mere abstention from dealing cannot *per se* be price fixing, because the price is not made to depend upon any contract or agreement even thought, by the parties, to be enforceable. To call defendant's acts price fixing, is inaccurate, and evades obvious legal questions, *viz.*, whether defendant has the right to decline business; and whether it is anybody's business why the business is declined. Therefore, because I cannot accept the meaning imputed to the words used by plaintiff, it is not found necessary to reach the conclusion of the first proposition.

Concerning the second syllogism, it must be admitted that there is abundant authority for the general proposition that preventing competition is restraint of trade; but it does not follow that it is unlawful either to prevent any and every species of competition, or to restrain trade in any and every degree. The only competition prevented or sought to be prevented by defendant's acts, is that of Cream of Wheat against itself; the only trade restrained is the commercial warfare of a large buyer against small ones, or that of a merchant who for advertising purposes may sell an article at a loss, in order to get customers at his shop, and then persuade them to buy other things at a compensating profit. That competition as encouraged by statutes and decisions, does not include such practices, has been sufficiently shown (with ample citations) in *Fisher Flouring Mills Co. v. Swanson,* 76 Wash. 649.

It is further obvious, that when plaintiff premises that preventing competition is restraining trade, it is assumed that the resultant restraint is *unreasonable;* for there is nothing in the Clayton Act to compel or induce courts to hold that the trade restraint referred to by this statute, differs in kind, quality or degree, from that now held to be meant by the Sherman Act.

Because, therefore, I am not persuaded that the acts of defendant have produced, or tend to produce, diminution of any competition favored by reason or law, or have restrained trade

unreasonably (if at all), I do not find it necessary to accede to the second syllogism.

Mere doubt of the propositions of plaintiff would require refusal of preliminary injunction; but I may more distinctly state my reasons for thinking that even definite, positive and admitted price regulation is not unreasonable restraint of trade in the present instance.[6]

Cream of Wheat is not a necessity, it is not even a staple article of commerce. If it be a commodity at all, the commodity and the name are synonymous. Its continued existence depends upon defendant's ability to control the marketing of its own product. The doing of what plaintiff wishes, would take from every groceryman near an "Economy Store" the last incentive to buy any Cream of Wheat, and collectively such grocery keepers are more important to the public and the defendant than is the plaintiff. If injunction were granted, defendant and many retailers would be injured, and the microscopic benefit to a small portion of the public would last only until plaintiff was relieved from the competition of the fourteen cent grocers—when it, too, would charge what the business would normally and naturally bear. In short, it is plaintiff and not defendant that pursues methods, whose hardship and injustice have often been judicially conmmented upon. (*U. S. v. Freight Assn.,* 166 U. S. 321.)

In my judgment the prevention or limitation of practices such as plaintiff's (so far as consistent with Statute Law) is the reverse of unreasonable.

§54 *HARTWELL v. GURNEY*

Supreme Court of Rhode Island, 1888. [16 *R. I.* 78.]

[A trustee of property at an auction sale held by him employed a "puffer" to enhance the price.]

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[6]There is surely a very obvious difference between enforcing by legal process an agreement to regulate prices, and regulating prices by legal process. The agreement may be, and usually is unenforceable; *Bauer v. O'Donnell,* 229 U. S. 1 gives the reasons; but it is not necessarily unlawful for a man to do voluntarily what he cannot be compelled to do. It follows, therefore, that, even under the Clayton Act, price regulation accomplished without undue or unreasonable trade restraint, and by a judicious selection of customers, may be lawful. It seems to be argued for plaintiff, that because defendant could not enforce a price agreement, it cannot by any method accomplish, even partially, the same result. It is an amusing commentary on this doctrine that the main object of this suit is to have this Court *compel* delivery of Cream of Wheat at $3.95 per case—which is *pro tanto* price fixing. [On price-fixing agreements see §§192, 193 *infra.*]

DURFEE, C. J.: . . . This property was advertised for sale at auction. At the auction sale it was struck off for $3,500 to David Goff, he being the highest bidder. Goff, however, was employed by the defendant to bid for the purpose of enhancing the price and preventing a sacrifice, and his bid was made accordingly. The next highest bid was $3,475. The testimony shows to our satisfaction that this bid was *bona fide,* that the bidder was responsible, and that he would have taken the property and paid for it if he had not been overbid by Goff. After the auction was over, the property was offered to him for the price bid and refused. . . . The creditors [the persons in-
may be decreed to account, and that he be charged in account
may be decreed to account, and that he be charged in account
either with the $3,475 which he might have received but for Goff's bid, or the $3,500 bid by Goff, and that the property so sold to Goff may be the defendant's property by virtue of the sale. The question is whether they are entitled to the relief asked for.

The defendant contends that Goff, in making the bid, acted not for him individually, but for him in his capacity of assignee and for the benefit of the creditors, and that he cannot therefore be charged as purchaser. This raises the question whether as assignee he had any right to employ a puffer or by-bidder to protect the property for the creditors. Formerly in England there was a conflict between the law and the equity courts, the law courts holding that by-bidding or puffing was a fraud, and that any highest bidder who had been deceived by it could avoid his contract, or refuse to carry it out ; whereas the equity courts were disposed to countenance it so long as it was employed defensively to prevent a sacrifice. The doctrines at common law and in equity have recently, A. D. 1867, been assimilated in England, as least so far as regards auction sales of real estate, by statute making the rule at common law likewise the rule in equity. 2 Addison on *Contracts,* *868; Bateman on *Auctions,* *131-*136. In this country there are cases which, following the old English chancery rule, hold that the vendor may employ a by-bidder if he does it *bona fide* to prevent a sacrifice of the property under a given price. Benjamin on *Sales,* §474, n.r. But, in our opinion, the rule which is the more authoritatively established, is that by-bidding is illegal, and that the vendor cannot hold the purchaser where the price has been run up by means thereof. Benjamin on *Sales,* §470, n.k.; Bateman on *Auctions,* *131, n.1; *Veazie v. Williams,* 8 How. U. S. 134; *Moncrieff v. Goldsborough,* 4 Har. & McH. Md. 283; *Towle v. Leavitt,* 23 N. H. 360; *Baham v. Bach,* 13 La. 287; *Smith v. Greenlee,*

2 Dev. 126; *Morehead v. Hunt,* 1 Dev. Eq. 35; *Trust v. Delaplaine,* 3 E. D. Smith, 219; *National Bank of Metropolis v. Sprague,* 20 N. J. Eq, 159; *Pennock's Appeal,* 14 Pa. St. 446, 449; *Staines v. Shore,* 16 Pa. St. 200; *Peck v. List,* 23 W. Va. 338; 48 Amer. Rep. 398. The last named case very ably reviews the decisions with copious quotations from them. It seems to us that the stricter rule is the just and honest rule, and that it ought to prevail; for an offer to sell at auction is an offer to sell to the highest bidder, and every bid is an inchoate acceptance, entitling the bidder to the property offered, if it turns out to be the highest, and there is no retraction on either side before the hammer falls; and therefore it is a breach of faith, a falsehood, a fraud, for the vendor to have a person employed to make a feigned bid for the purpose of beguiling the real bidder into virtually over-bidding himself. By-bidding, in other words, is a violation of the terms on which the people assembled at the sale are invited to compete with one another for the property exposed.

The language used by Lord Mansfield in the leading case of *Bexwell v. Christie,* 1 Cowp. 395, is especially apt: "The basis of all dealings ought to be in good faith," said he, "so more especially in these transactions where the public are brought together upon the confidence that the articles set up to sale will be disposed of to the highest real bidder, which could never be the case if the owner might secretly and privately enhance the price by a person employed for that purpose." In *Howard v. Castle,* 6 Term Rep. 642, Lord Kenyon, approving Lord Mansfield's decision in *Bexwell v. Christie,* pronounced his reasoning to be "founded on the noblest principles of morality and justice; principles which are calculated to preserve honesty between man and man." And in *Pennock's Appeal,* 14 Pa. St. 446, 449, Gibson, C. J., well says: "Common honesty requires that all should be fair and above-board. To screw up the price, as it has been aptly termed, by secret machinery, can be no less than a fraud, and a sham bidder can be used for no other purpose." If it be said that without by-bidding the property offered may be sacrificed, the answer is that it is not necessary to offer it without reserve, and the risk of sacrifice may be avoided by publicly reserving the right to bid or to make one or more bids, in the conditions of sale, or by starting the sale at an upset price. In this or some similar way good faith may be kept with the bidders, and at the same time the property be protected. . . .

This loss should not fall on the creditors. It was the defendant's duty to sell, not keep it for them. Indeed, his offer to the *bona fide* bidder after the auction shows that his purpose in

bidding was not to keep it for them, but to puff the price. Let him be decreed to have the property, and to account for it at the price bid by him.

§55. *By-bidding at Auctions.*—In English law there was a time when the rules as to puffing furnished an instance of a higher moral standard being recognized by law than by equity. Generally it has been the other way, since equity represents in the main an infusion of morals into the law. It is interesting that, although generally equity prevails over the law, in this instance where the law set forth a higher standard of conduct it prevailed. The distinction between law and equity with regard to the employment of puffers never existed in this country.

The explanation of the attitude of the law towards "puffing" or "by-bidding" is, in part at least, that in Roman law a transaction of the type of an auction was a transaction *bonae fidei,* in which the parties were not conceived of as dealing with each other at arm's length. Lord Mansfield, whose authority is relied upon in this case, was trained in the Roman system and was not averse to introducing its standards into the business law of England; in fact, during his justiceship, law was temporarily more flexible and more responsive to new needs than equity.[1] From a business point of view what considerations should control in determining the extent to which an auction sale is a transaction *bonae fidei?* Is the auction a transaction, as a matter of fact, in which the parties deal with each other at arm's length? Or does it call for special regulation by the state?

§56. *Honest Advertising Laws.*—Within the present decade laws have been passed in more than half our states prohibiting the publication or circulation of false or misleading advertisements concerning property which is offered for sale. How sweeping in extent some of these statutes are is apparent from the following quotation from the New Jersey act:

> "Any person, firm, corporation or association who, with intent to sell or in any wise dispose of merchandise, securities, service, or anything offered by such person,

[1] *Cf.* §5 *supra.*

firm, corporation or association, directly or indirectly, to the public for sale or distribution, or with intent to increase the consumption thereof, or to induce the public in any manner to enter into any obligation relating thereto, or to acquire title thereto, or an interest therein, makes, publishes, disseminates, circulates, or places before the public or causes, directly or indirectly, to be made, published, disseminated, circulated, or placed before the public, in this State, in a newspaper or other publication, or in the form of a book, notice, hand-bill, poster, bill, circular, pamphlet or letter or in any other way, an advertisement of any sort regarding merchandise, securities, service, or anything so offered to the public, which advertisement contains any assertion, representation or statement of fact which is untrue, deceptive or misleading, shall be guilty of a misdemeanor.'' [New Jersey Laws (1913), ch. 318.]

PART II

THE LAW OF CONTRACTS, WITH SPECIAL REFERENCE TO THE RELATION OF BUYER AND SELLER

CHAPTER VII

THE MAKING OF CONTRACTS

Introductory: The Essential Elements of a Contract

§57. *From Williston, The Law of Contracts* (1920) *Vol.* 1, *p.* 17.—"The requirements for the formation of a simple contract are: (1) Parties of legal capacity; (2) an expression of mutual assent of the parties to a promise or set of promises (3) an agreed valid consideration. The agreement must also not be declared void by statute or common law. The requirement last enumerated has often been too broadly stated; namely, that the agreement must not be illegal. But all illegal contracts are not void. Possibility of performance, which is also stated by some writers as requisite, does not seem essential. Parties may contract to do something which is impossible, if they wish to do so, though, doubtless if they know of the impossibility, it will generally be assumed that they do not. Two other supposed requirements have also been suggested: Genuineness of consent, and intent to contract."

§58. *The Elements of a Contract.*—Professor Williston does not regard genuineness of consent or intent of the parties essential, largely because (1) genuineness of consent is included under the general heading of assent; and (2) because the views of parties as to what are the requirements of a contract are wholly immaterial. Furthermore, these terms suggest a subjective standard, a looking into the minds of the parties, which, of course, is impossible. Nevertheless, it is convenient to reserve a heading under which to deal with the exceptional conditions permitting a *prima facie* contract to be either set aside or ignored.

In addition, to cover the case of particular contracts based

on or evidenced by certain forms, "form" may be considered alongside of consideration.

Subject to these restrictions, it will serve our purpose to organize the study of the formation of contracts along the traditional lines in the order succinctly stated in Anson on *Contracts* (Corbin's edition, 1919, p. 14), as follows:

> 1. A distinct communication by the parties to one another of their intention; in other words, offer and acceptance.
> 2. The presence of certain evidence, required by law, of the intention of the parties to affect their legal relations. This evidence is either (a) form, or (b) consideration.
> 3. The capacity of the parties to make a valid contract.
> 4. The genuineness of the consent expressed in offer and acceptance.
> 5. The legality of the objects which the contract proposes to effect.

A. Offer and Acceptance

§59. *In General.*—The legal rghts and liabilities that arise out of the conduct of a business enterprise are predominantly based upon the consent of the parties. It is true of course in business as in all other affairs that an act has legal consequences whenever it constitutes a breach of a general duty imposed by law. Nevertheless, the activities of business, more than any other class of activities, fall within the sphere within which men are permitted to bind each other by their deliberate dealings. In sales of goods, in contracts of all kinds, and in the internal arrangement of business associations, the legal relations of the parties are in large measure the ones stipulated for by agreement.

It is but rarely that the parties to any agreement of the kind which results in new legal relations between them, express their assent simultaneously. Nearly always such an agreement is arrived at by a process of offer and acceptance of terms.[1] Ac-

[1] In the creation of the agency relation the constituent elements of the agreement are spoken of as "appointment," or "authorization," and "acceptance of appointment."

cordingly, after a preliminary survey of the fundamental characteristics of all agreements which operate to create new legal relations, this division is devoted to a discussion of the rules relating to offer and acceptance.

§60. *Fundamental Characteristics of Mutual Assent: Rights and Duties Under an Agreement Arise Only When the Parties Have Expressed Assent as to All Its Essential Terms.*—It is not a function of the courts to make agreements for people. It follows that an agreement creates no legal relations between the parties unless there be a complete and definite expression of its terms. If, for example, a seller promises a distributor of his goods that he will deal with the latter in such a way as to "protect his trade," by which the parties understand that the distributor is assured of being able to buy on such terms that he will be able successfully to compete with his trade rivals, the arrangement is plainly too indefinite and too general to be enforceable.[1]

It is not absolute, but reasonable definiteness in the expression of terms that the law requires in agreements. Accordingly, specific mention of all the terms of a bargain is not essential to the validity of an agreement. For example, if a man be engaged to perform certain services, a binding contract may exist even though there be no stipulation as to the specific amount of his compensation. The law assumes the existence of a common intention that he is to be paid a reasonable remuneration,—an amount which of course depends upon the nature and character of the work, and, to some extent, depends upon the standing of the one employed to do it. The crucial inquiry, therefore, is not, Have the parties made specific mention of every element involved in their agreement; but, Have the parties from the standpoint of reasonable men arrived at a complete understanding? In answering the latter question, a court aims to take into consideration all the circumstances of each particular case and to give to them a reasonable commercial interpretation. Sometimes, for instance, a previous course of dealing may prove to be the deci-

[1] *Marble v. Standard Oil Co.* (1897), 169 Mass. 553.

sive factor. So, also, proof of a trade usage often makes the answer easy. There is perhaps no need to remind the reader that stipulations contained in a writing may be incorporated into the agreement by proper reference to the writing. This is the effect, for instance, of the provision contained in Article 4 of the standard form of agreement issued by the American Institute of Architects, providing that the drawings and specifications are made part of the building contract.

§61. *Fundamental Characteristics of Mutual Assent: Rights and Duties Under an Agreement Arise Only When the Parties Have Expressed an Intention to Create New Legal Relations.*—An agreement may be definite and certain in its terms and nevertheless leave the legal rights and duties of the parties *inter se* entirely unaffected. Such is the case whenever the reasonable meaning of the words and acts of the parties indicates that the agreement is to be without legal significance; for instance, when an agreement is made with respect to a social engagement, or when an agreement is made in jest.[1]

What is important in the law is not the thought process of the individual but the meaning which would reasonably attach to his words and conduct. Sometimes the general relations in which the parties stand to each other lead one to the conclusion that the parties have in effect stipulated that their engagements should be unsupported by the coercive arm of the law.

§62. *DISBROW v. DURAND*

New Jersey Court of Errors and Appeals, 1892. [54 *N. J. L.* 343.]

[The plaintiff sued for the value of her services as her brother's housekeeper during the six years preceding the brother's death. No proof was offered by the plaintiff to show that she expected compensation for her services at the time they were rendered, and that her brother was aware of this expectation.] McGILL, CH., "Ordinarily, where services are rendered and voluntarily accepted, the law will imply a promise upon the part

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[1]It should be observed, however, that one who buys a negotiable instrument in good faith before its maturity may enforce it, even though the original parties to the instrument were aware that it was executed in jest.

of the recipient to pay for them; but where the services are rendered by members of a family, living as one household, to each other, there will be no such implication, from the mere rendition and acceptance of the services. . . . The reason of this exception to the ordinary rule is that the household family relationship is presumed to abound in reciprocal acts of kindness and good will, which tend to the mutual comfort and convenience of the members of the family, and are gratuitously performed. . . ." [Plaintiff non-suited.]

§63. *Business Engagements Without Compensation.*—Even in a business organization a similar presumption may exist, for example, directors or other officers of a corporation are not entitled to any compensation for services in the regular course of their employment, apart from an express agreement to that effect. Moreover, everyone knows that the business world is honeycombed with mere engagements of honor,—"gentlemen's agreements," as they are called.[1]

§64. *Contract and Writing.*—After the parties have agreed upon all terms, but have also agreed to embody them in writing, the question whether legal rights and liabilities exist prior to the execution of the contemplated instrument is determined by the underlying principle under discussion; but the application of the principle to the facts of a particular case is frequently no easy task. The number of the details in the agreement, the amount involved, the prevailing practice and understanding with respect to an agreement of its kind, and similar considerations are taken into account. One should therefore not be unprepared, especially in commercial transactions, for finding that the writ-

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[1]Of course, certain agreements of this kind are illegal. Thus in *U. S. v. U. S. Steel Corp. et al.*, (1915) 223 Fed. 55, 161 (Dist. Ct., D. N. J.) it was said of the "Gary dinners" as follows: "Certainly there was no positive and express obligation; no formal words of contract were used; but most of those who took part in these meetings went away knowing that prices had been named, and feeling bound to maintain them until they saw good reason to do otherwise, and feeling bound to maintain them even then until they had signified to their associates their intention to make a change. We cannot doubt that such an arrangement or understanding or moral obligation—whatever name may be the most appropriate—amounts to a combination or common action forbidden by law." Buffington, J.

ing constitutes nothing more than a convenient record of a bargain reasonably understood to have been previously concluded.

§65. *SANDERS v. POTTLITZER BROTHERS FRUIT COMPANY.*

Court of Appeals of New York, 1894. [144 *N. Y.* 209.]

O'BRIEN, J.: The plaintiffs in this action sought to recover damages for the breach of a contract for the sale and delivery of a quantity of apples. The complaint was dismissed by the referee and his judgment was affirmed upon appeal. The only question to be considered is whether the contract stated in the complaint, as the basis for damages, was ever in fact made so as to become binding upon the parties. On October 28, 1891, the plaintiffs submitted to the defendant the following proposition in writing:

"Buffalo, N. Y., October 28, 1891.

"Messrs. Pottlitzer Bros. Fruit Co., Lafayette, Ind.

"Gentlemen: We offer you ten carloads of apples to be from 175 to 200 barrels per car, put up in good order, from stock inspected by your Mr. Leo Pottlitzer at Nunda and Silver Springs. The apples not to exceed one-half green fruit, balance red fruit, to be shipped as follows:

"First car between December 1 and 15, 1891.

"Second car between December 15 and 30, 1891, and one car each ten days after January 1, 1892, until all are shipped. Dates above specified to be considered as approximate a few days either way, at the price of $2.00 per barrel, free on board cars at Silver Springs and Nunda, in refrigerator cars, this proposition to be accepted not later than the 31st inst. and you to pay us $500 upon acceptance of the proposition, to be deducted from the purchase price of apples at the rate of $100 per car on the last five cars.

"Yours respectfully,

"J. SANDERS & SON."

To this proposition the defendant replied by telegraph on October 31, as follows:

"Lafayette, Ind., October 31.

"J. Sanders & Son:

"We accept your proposition on apples, provided you will change it to read every eight days from January 1, none in December; wire acceptance.

POTTLITZER BROS. FRUIT CO."

On the same day the plaintiffs replied to this despatch to the effect that they could not accept the modification proposed, but must insist upon the original offer. On the same day the defendant answered the plaintiffs' telegram as follows:

> "Can only accept condition as stated in last message. Only way we can accept. Answer if accepted. Mail contract and we will then forward draft.
>
> "POTTLITZER BROS. FRUIT CO."

The matter thus rested till November 4, when the plaintiffs received the following letter from the defendant:

> "Lafayette, Ind., November 2, 1891.
>
> "J. Sanders & Son., Stafford, N. Y.
>
> "Gents: We are in receipt of your telegrams, also your favor of the 31st ult. While we no doubt think we have offered you a fair contract on apples, still the dictator of this has learned on his return home that there are so many near-by apples coming into the market that it will affect the sale of apples in December, and, therefore, we do not think it advisable to take the contract unless you made it read for shipment from January 1st. We are very sorry you cannot do this, but perhaps we will be able to take some fruit from you, as we will need it in the spring. If you can change the contract so as to read as we wired you we will accept it and forward you draft in payment on same.
>
> "POTTLITZER FRUIT CO."

On receipt of this letter the plaintiffs sent the following message to the defendant by telegraph:

> "November 4.
>
> "Pottlitzer Bros. Fruit Co., Lafayette, Ind.
>
> "Letter received. Will accept conditions. If satisfactory, answer and will forward Contract.
>
> "J. SANDERS & SON."

The defendant replied to this message by telegraph, saying: "All right, send contract as stated in our message." The plaintiffs did prepare and send on the contract precisely in the terms embraced in the foregoing correspondence, which was the original proposition made by the plaintiffs, as modified by defendant's telegram above set forth, and which was acceded to by the plaintiffs. This was not satisfactory to the defendant, and it returned it to the plaintiffs with certain modifications, which were not referred to in the correspondence. These modifications

were: (1) That the fruit should be well protected from frost and well hayed; (2) that if, in the judgment of the plaintiffs, it was necessary or prudent that the cars should be fired through, the plaintiffs should furnish the stoves for the purpose, and the defendant pay the expense of the man to be employed in looking after the fires to be kept in the cars; (3) that the plaintiffs should line the cars in which the fruit was shipped. These conditions were more burdensome and rendered the contract less profitable. They were not expressed in the correspondence, and I think cannot be implied. They were not assented to by the plaintiffs, and on their declining to incorporate them in the paper the defendant treated the negotiations as at an end, and notified the plaintiffs that it had placed its order with other parties. There was some further correspondence, but it is not material to the question presented by the appeal. The writings and telegrams that passed between the parties contain all the elements of a complete contract. Nothing was wanting in the plaintiffs' original proposition but the defendant's assent to it in order to constitute a contract binding upon both parties according to its terms. This assent was given upon condition that a certain specified modification was accepted. The plaintiffs finally assented to the modification and called upon the defendant to signify its assent again to the whole arrangement as thus modified, and it replied that it was "all right," which must be taken as conclusive evidence that the minds of the parties had met and agreed upon certain specified and distinct obligations which were to be observed by both. It is true, as found by the learned referee, that the parties intended that the agreement should be formally expressed in a single paper which, when signed, should be the evidence of what had already been agreed upon. But neither party was entitled to insert in the paper any material condition not referred to in the correspondence, and if it was inserted without the consent of the other party it was unauthorized. Hence the defendant, by insisting upon further material conditions not expressed or implied in the correspondence, defeated the intention to reduce the agreement to the form of a single paper signed by both parties. The plaintiffs then had the right to fall back upon their written proposition as originally made and the subsequent letters and telegrams, and if they constituted a contract of themselves the absence of the formal agreement contemplated was not under the circumstances material. When the parties intend that a mere verbal agreement shall be finally reduced to writing as the evidence of the terms of the contract, it may be true that nothing is binding upon either party until the writing is executed.

But here the contract was already in writing, and it was none the less obligatory upon both parties because they intended that it should be put into another form, especially when their intention is made impossible by the act of one or the other of the parties by insisting upon the insertion of conditions and provisions not contemplated or embraced in the correspondence. (*Vassar v. Camp,* 11 *N. Y.* 441; *Brown v. Norton,* 50 *Hun* 248; *Pratt v. H. R. R. R. Co.,* 21 N. Y. 308). The principle that governs in such cases was clearly stated by Judge Selden in the case last cited in these words: "A contract to make and execute a certain written agreement, the terms of which are mutually understood and agreed upon, is, in all respects, as valid and obligatory, where no statutory objection interposes, as the written contract itself would be, if executed. If, therefore, it should appear that the minds of the parties had met; that a proposition for a contract had been made by one party and accepted by the other; that the terms of this contract were in all respects definitely understood and agreed upon, and that a part of the mutual understanding was, that a written contract, embodying these terms, should be drawn and executed by the respective parties, this is an obligatory contract, which neither party is at liberty to refuse to perform."

In this case it is apparent that the minds of the parties met through the correspondence upon all the terms as well as the subject-matter of the contract, and that the subsequent failure to reduce this contract to the precise form intended, for the reason stated, did not affect the obligation of either party, which had already attached, and they may now resort to the primary evidence of their mutual stipulations. Any other rule would always permit a party who has entered into a contract like this through letters and telegraphic messages to violate it whenever the understanding was that it should be reduced to another written form, by simply suggesting other and additional terms and conditions. If this were the rule the contract would never be completed in cases where by changes in the market or other events occurring subsequent to the written negotiations it became the interest of either party to adopt that course in order to escape or evade obligations incurred in the ordinary course of commercial business. A stipulation to reduce a valid written contract to some other form cannot be used for the purpose of imposing upon either party additional burdens or obligations or of evading the performance of those things which the parties have mutually agreed upon by such means as made the promise or assent binding in law. There was no proof of any custom existing between the shippers and consignees of such property in re-

gard to the payment of the expense of firing, lining, and haying the cars. If it be said that such precautions are necessary in order to protect the property while in transit, that does not help the defendant. The question still remains, who was to bear the expense? The plaintiffs had not agreed to pay it any more than they had agreed to pay the freight or incur the other expenses of transportation. The plaintiffs sent a plain proposition which the defendant accepted without any such conditions as it subsequently sought to attach to it. That the parties intended to make and sign a final paper does not warrant the inference that they also intended to make another and different agreement. The defendant is in no better position than it would be in case it had refused to sign the final writing without alleging any reasons whatever. The principle, therefore, which is involved in the case is this: can parties who have exchanged letters and telegrams with a view to an agreement, and have arrived at a point where a clear and definite proposition is made on the one side and accepted on the other, with an understanding that the agreement shall be expressed in a formal writing, ever be bound until that writing is signed? If they are at liberty to repudiate the proposition or acceptance, as the case may be, at any time before the paper is signed, and as the market may go up or down, then this case is well decided. But if at the close of the correspondence the plaintiffs became bound by their offer, and the defendant by its acceptance of that offer, whether the final writing was signed or not, as I think they did, under such circumstances as the record discloses, then the conclusion of the learned referee was erroneous. To allow either party to repudiate the obligations clearly expressed in the correspondence, unless the other will assent to material conditions, not before referred to, or to be implied from the transaction, would be introducing an element of great confusion and uncertainty into the law of contracts. If the parties did not become bound in this case, they cannot be bound in any case until the writing is executed.

The judgment should be reversed and a new trial granted, costs to abide the event.

All concur, except Earl, Gray, and Bartlett, JJ., dissenting.

Judgment reversed.

§66. *Preliminary Negotiations and Agreement Distinguished.* —Is a contract the paper in which an agreement is embodied, or the agreement itself, or the relation flowing from an agreement? The term is loosely used in all of these senses. The confusion in the minds of the defendants in the foregoing case on this

point led them to suppose that until they had signed the formal agreement, there was no contract between them. It is, of course, true that a great deal of mere negotiation may precede the making of a contract, and it is necessary to distinguish carefully between such negotiation and the consummation of the agreement.

To avoid dispute and possible litigation, one who wishes the preliminary agreement to be without binding force until the execution of the contemplated document will do well to state, in effect: "It must be understood that nothing is to be binding on either side until the written agreement is assented to by both sides."

§67. *Rights and Duties Under an Agreement Arise Only When the Parties Have Expressed Their Common Intention in a Way Which the Law Deems Adequate.*—Agreements, to have legal significance, must not only be manifested but must be manifested in a way which the law either requires or sanctions.

The agreement between the parties, or, as will presently be seen, special statutes may make the observance of formalities necessary in order to make an agreement legally enforceable. Subject to these qualifications, it may be stated as a general rule that no formalities of any kind are necessary in order to make the expression of agreement legally effective. With respect to the great mass of everyday business agreements, it is a vulgar error to suppose that the law requires certain cabalistic words, or the shaking of hands, or even a scrap of paper. A declaration of intention may be made by conduct, signs, spoken words, writing, or by a combination of these ways. If, for example, one requests a tradesman by telephone to send certain goods, the mere ordering of the goods would, in a normal case, reasonably carry with it a promise to the tradesman to pay for the goods if they are supplied. "Whenever circumstances arise in the ordinary business of life in which if two persons were ordinarily honest and careful, the one of them would make a promise to the other, it may properly be inferred that both of them understood that such a promise was given and accepted."[1]

[1] *Ex parte Ford* (1885), 16 Q. B. D. 305, 307, per Lord Esher, M. R.

Even as regards a written agreement no particular mode of expressing assent to its terms is required. There is a rather common notion among the uninformed that if the agreement be signed, the signatures and execution of the instrument should be attested by one or more witnesses, but this is a misconception.[2]

If one of the parties actually signs an instrument which he knows, or should reasonably know, contains the terms of an agreement, he expresses his assent to its contents and to whatever additional terms are incorporated in the writing by a reference to them, even if he has not read the document, or has been content to adopt "in the dark" those terms which were not set out in the writing.[3] But other ways of indicating assent to a written agreement are equally effective, it being established that "although not signed by the party suing on it, if it is clear either from his words or actions that he assented to it from the first, he must comply with, and may enforce, its obligations."[4] As an illustration, reference may be made to the way in which assent is usually expressed to the written "deposit agreements" prepared by reorganization committees of corporations which are in financial difficulties. If a bondholder, for example, deposits his bond with one of these committees in accordance with a written "deposit agreement" prepared by the committee and accepts a receipt therefor in exchange, he binds himself to the terms of the written agreement as fully as if he had actually signed it.

The effect of the mere act of taking possession of a document that contains the terms of an agreement depends upon the nature of the document. The accepted doctrine is that one who accepts

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[2]In many states a will is the only instrument to which subscribing witnesses are necessary. In some states attestation by witnesses is essential in deeds of real estate also.

It is the common-law rule that whenever an instrument on being produced in court appears to be attested by witnesses, at least one of the witnessess, if any are living, must be called to prove the execution of the document, even though the document is one which is not required by law to be attested. A number of states have very sensibly passed statutes abolishing this rule with respect to all writings except those whose validity depends upon attestation.

[3]*Violette v. Rice* (1899), 173 Mass. 82, printed below §131.

[4]*American Publishing Co. v. Walker* (1901), 87 Mo. App. 503. If, however, a memorandum is necessary in order to comply with the Statute of Frauds, it is inadequate unless it is signed by the party to be charged therewith. See §§122, 126, *infra*.

the custody of a document has adequately expressed assent to its terms, provided he knows or should reasonably know that the document contains the terms of an agreement, even though he may not choose to inform himself of the terms. The application of this principle does not, in many situations, occasion especial difficulty. Thus, the holder of a corporation bond must be taken to have assented to all the terms and conditions set forth in the bond, and in addition to all the terms of any instrument which is incorporated therein by reference, for example, the lengthy deed of trust which secures the bond issue. The form of a corporation bond indicates to a reasonable man that it contains a statement of the terms governing the loan made by the borrowing corporation. On the other hand, the mere acceptance of a document which could reasonably be regarded as only a voucher or a receipt does not of itself constitute an assent to the terms contained in the instrument. As regards the effect of acceptance of one of the commonest documents in business, namely, the bill of lading, the adjudications are not unanimous.[5]

§68. *Requisites of an Offer.*—To be an offer the terms proposed must be definite and certain or capable of being made certain. In view of what had already been said, the only matter which requires discussion is the operation of the maxim, "That is certain which can be rendered certain."

Consider, for example, a proposal to sell goods without specifying the quantity of goods which are to pass under the bargain. Frequently, of course, such a statement of price reasonably indicates only a purpose of encouraging the buyer to make an offer. If, however, it is reasonably apparent that the one to whom the proposal was made was invited "to close the contract," a seasonable acceptance which indicates the amount or quantity of the goods which are to pass under the bargain concludes the agreement.

To be an offer the terms proposed must raise reasonable ex-

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[5]The majority of courts rule that an acceptance of this instrument by a shipper indicates his assent to its terms. In Illinois, however, and in one or two other states, the question of the shipper's assent is always submitted to the jury as a question of fact in each particular case.

pectations that upon a mere acceptance of the terms new legal relations will arise. Among the devices employed in business to encourage customers and the general public to make "inquiries" and to negotiate for terms are proposals of various kinds. In every case it is necessary, therefore, to determine whether the one making a proposal reasonably indicates that he reserves for himself perfect freedom of action irrespective of the response he will receive, or whether he leads another reasonably to believe that new legal relations between them will follow upon a mere expression of assent to the terms proposed. When the parties express themselves in writing, the decision of this question devolves upon the court, for it is a rule of law that the construction of all written instruments is a function to be performed by the court.

When the parties negotiate with each other by word of mouth what the one making a proposal said and did is a question for the jury; but it seems that the further question of fact whether or not the party to whom the proposal is made is justified in assuming upon the basis of the ascertained facts that he was empowered to create new legal relations by accepting the terms, is a question to be determined by the court.

In certain well-defined situations in which the latter question recurs again and again the findings of the courts have crystallized into rules of law. Thus, the exposing of goods in a shop window with price tags attached, without more, is held to amount simply to an invitation to negotiate. Similarly, price quotations made in other ways are held to be acts of mere preliminary negotiation. "The order of the prospective buyer does not ripen into a contract until the defendant's acceptance."[1]

§69. *MOULTON v. KERSHAW*

Supreme Court of Wisconsin, 1884. [59 *Wis.* 316.]

[Defendants wrote plaintiff as follows: "In consequence of a rupture in the salt trade, we are authorized to offer Michigan fine salt in full car-load lots of eighty to ninety-five bbls. delivered in your city at 85c per bbl. At this price it is a bargain, as the price in general remains unchanged. Shall be pleased to receive

[1]*Montgomery Ward & Co. v. Johnson* (1911), 309 Mass. 89, 91.

your order.'' Thereupon the plaintiff telegraphed as follows: ''Your letter of yesterday received and noted. You may ship me 2,000 bbls. Michigan fine salt, as offered in your letter.'']

TAYLOR, J.: . . . We are very clear that no contract was perfected by order telegraphed by the respondent in answer to appellant's letter. . . . Rather than introduce such an element of uncertainty into the contract, we deem it much more reasonable to construe the letter as a simple notice to those dealing in salt that the appellants were in a condition to supply that article for the prices named, and requesting the person to whom it was addressed to deal with them. This case is one where it is eminently proper to heed the injunction of Justice FOSTER in the opinion in *Lyman v. Robinson,* 14 Allen, 254: ''That care should always be taken not to construe as an agreement letters which the parties intended only as preliminary negotiations.''

We do not wish to be understood as holding that a party may not be bound by an offer to sell personal property, where the amount or quantity is left to be fixed by the person to whom the offer is made, when the offer is accepted and the amount or quantity fixed before the offer is withdrawn. We simply hold that the letter of the appellants in this case was not such an offer. If the letter had said to the respondent we will sell you all the Michigan fine salt you will order, at the price and on the terms named, then it is undoubtedly the law that the appellants would have been bound to deliver any reasonable amount the respondent might have ordered, possibly any amount, or make good their default in damages. The case cited by the counsel decided by the California Supreme Court, (*Keller v. Ybarru,* 3 Cal., 147) was an offer of this kind with an additional limitation. The defendant in that case had a crop of growing grapes, and he offered to pick from the vines and deliver to the plaintiff, at defendant's vineyard, so many grapes then growing in said vineyard as the plaintiff should wish to take during the present year at ten cents per pound on delivery. The plaintiff, within the time and before the offer was withdrawn, notified the defendant that he wished to take 1,900 pounds of his grapes on the terms stated. The court held there was a contract to deliver the 1,900 pounds. In this case the fixing of the quantity was left to the person to whom the offer was made, but the amount which the defendant offered, beyond which he could not be bound, was also fixed by the amount of grapes he might have in his vineyard in that year. The case is quite different in its facts from the case at bar.

The cases cited by the learned counsel for the appellants (*Beaupre v. P. & A. Tel. Co.,* 21 Minn., 155, and *Kinghorne v.*

Montreal Tel. Co., U. C. 18 Q. B., 60) are nearer in their main facts to the case at bar, and in both it was held there was no contract. We, however, place our opinion upon the language of the letter of the appellants, and hold that it cannot be fairly construed into an offer to sell to the respondent any quantity of salt he might order, nor any reasonable amount he might see fit to order. The language is not such as a business man would use in making an offer to sell to an individual a definite amount of property. The word "sell" is not used. They say, "we are authorized to offer Michigan fine salt," etc., and volunteer an opinion that at the terms stated it is a bargain. They do not say, we offer to sell to you. They use general language proper to be addressed generally to those who were interested in the salt trade. It is clearly in the nature of an advertisement or business circular, to attract the attention of those interested in that business to the fact that good bargains in salt could be had by applying to them, and not as an offer by which they were to be bound, if accepted, for any amount the persons to whom it was addressed might see fit to order. We think the complaint fails to show any contract between the parties, and the demurrer should have been sustained.[1]

§70. *Bids and Advertisements.*—There is a uniformity in the rulings which have been made with reference to circulars announcing an auction sale. A circular of this kind is construed by the courts not as an offer but merely as a proclamation that the owner is ready to receive offers.[1] The owner is therefore always at liberty to refuse any and all bids until a bid has been accepted, which is normally indicated by the falling of the auctioneer's hammer.[2]

Again, in the case of an invitation for bids for construction work, etc., courts construe the announcement not as an offer to award the contract to the lowest bidder, but only as a proclamation of willingness to consider offers from builders.

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[1]In the case of quotations, as in many other situations, it is necessary to distinguish between expediency and legality. It is undoubtedly good policy in making quotations to state that they are subject to change or withdrawal at any time without notice.

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[1]*Payne v. Cave* (1789), P. B. 3 Durnford and East Term. R. 148.
[2]Sec. 21 of the Uniform Sales Act does not permit the withdrawal of the goods from sale in case the auction has been announced to be without reserve. There are also statutes to the same effect in California, North Dakota, and South Dakota.

Although advertisements are usually merely invitations to deal, they may be issued in such a form as to amount to an offer. A good illustration of the way in which courts deal with a question of construction of this kind is furnished by the following case:

§71. *CARLILL v. CARBOLIC SMOKE BALL CO.*[1]

Court of Appeal, 1892. [1893, 1 Queen's Bench 256.]

The defendants, who were the proprietors and vendors of a medical preparation called "The Carbolic Smoke Ball," inserted in the *Pall Mall Gazette* of November 13, 1891, and in other newspapers, the following advertisement: "£100 reward will be paid by the Carbolic Smoke Ball Company to any person who contracts the increasing epidemic influenza, cold, or any disease caused by taking cold, after having used the ball three times daily for two weeks according to the printed directions supplied with each ball. £1,000 is deposited with the Alliance Bank, Regent Street, shewing our sincerity in the matter.

"During the last epidemic of influenza many thousand carbolic smoke balls were sold as preventives against this disease, and in no ascertained case was the disease contracted by those using the carbolic smoke ball.

"One carbolic smoke ball will last a family several months, making it the cheapest remedy in the world at the price, 10*s.*, post free. The ball can be refilled at a cost of 5*s.* Address, Carbolic Smoke Ball Company, 27 Princes Street, Hanover Square, London."

The plaintiff, a lady, on the faith of this advertisement, bought one of the balls at a chemist's, and used it as directed, three times a day, from November 20, 1891, to January 17, 1892, when she was attacked by influenza. Hawkins. J., held that she was entitled to recover the £100. The defendant appealed.

BOWEN, L. J.: . . . We were asked to say that this document was a contract too vague to be enforced.

The first observation which arises is that the document itself is not a contract at all; it is only an offer made to the public. The defendants contend, next, that it is an offer the terms of which are too vague to be treated as a definite offer, inasmuch as there is no limit of time fixed for the catching of the influenza, and it cannot be supposed that the advertisers seriously meant to promise to pay money to every person who catches the in-

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[1]For other parts of this case see §§100, 115.

fluenza at any time after the inhaling of the smoke ball. It was urged, also, that if you look at this document you will find much vagueness as to the persons with whom the contract was intended to be made—that, in the first place, its terms are wide enough to include persons who may have used the smoke ball before the advertisement was issued; at all events, that it is an offer to the world in general, and also, that it is unreasonable to suppose it to be a definite offer, because nobody in their senses would contract themselves out of the opportunity of checking the experiment which was going to be made at their own expense. It is also contended that the advertisement is rather in the nature of a puff or a proclamation than a promise or offer intended to mature into a contract when accepted. But the main point seems to be that the vagueness of the document shews that no contract whatever was intended. It seems to me that in order to arrive at a right conclusion we must read this advertisement in its plain meaning, as the public would understand it. It was intended to be issued to the public and to be read by the public. How would an ordinary person reading this document construe it? It was intended unquestionably to have some effect, and I think the effect which it was intended to have was to make people use the smoke ball, because the suggestions and allegations which it contains are directed immediately to the use of the smoke ball as distinct from the purchase of it. It did not follow that the smoke ball was to be purchased from the defendants directly, or even from agents of theirs directly. The intention was that the circulation of the smoke ball should be promoted, and that the use of it should be increased. The advertisement begins by saying that a reward will be paid by the Carbolic Smoke Ball Company to any person who contracts the increasing epidemic after using the ball. It has been said that the words do not apply only to persons who contract the epidemic after the publication of the advertisement, but include persons who had previously contracted the influenza. I cannot so read the advertisement. It is written in colloquial and popular language, and I think that it is equivalent to this: "£100 will be paid to any person who shall contract the increasing epidemic after having used the carbolic smoke ball three times daily for two weeks." And it seems to me that the way in which the public would read it would be this, that if anybody after the advertisement was published, used three times daily for two weeks the carbolic smoke ball, and then caught cold, he would be entitled to the reward. Then again it was said: "How long is this protection to endure? Is it to go on forever, or for what limit of time?" I think that there are two constructions

of this document, each of which is good sense, and each of which seems to me to satisfy the exigencies of the present action. It may mean that the protection is warranted to last during the epidemic, and it was during the epidemic that the plaintiff contracted the disease. I think, more probably, it means that the smoke ball will be a protection while it is in use. That seems to me the way in which an ordinary person would understand an advertisement about medicine, and about a specific against influenza. It could not be supposed that after you have left off using it you are still to be protected forever, as if there was to be a stamp set upon your forehead that you were never to catch influenza because you had once used the carbolic smoke ball. I think the immunity is to last during the use of the ball. That is the way in which I should naturally read it, and it seems to me that the subsequent language of the advertisement supports that construction. It says: "During the last epidemic of influenza many thousand carbolic smoke balls were sold, and in no ascertained case was the disease contracted by those using" (not "who had used") "the carbolic smoke ball," and it concludes with saying that one smoke ball will last a family several months (which imports that it is to be efficacious while it is being used), and that the ball can be refilled at a cost of 5*s*. I, therefore, have myself no hesitation in saying that I think, on the construction of this advertisement, the protection was to endure during the time that the carbolic smoke ball was being used. My brother, the Lord Justice who preceded me, thinks that the contract would be sufficiently definite if you were to read it in the sense that the protection was to be warranted during a reasonable period after use. I have some difficulty myself on that point, but it is not necessary for me to consider it further, because the disease here was contracted during the use of the carbolic smoke ball.

Was it intended that the £100 should, if the conditions were fulfilled, be paid? The advertisement says that £1000 is lodged at the bank for that purpose. Therefore, it cannot be said that the statement that £100 would be paid was intended to be a mere puff. I think it was intended to be understood by the public as an offer which was to be acted upon.

But it was said there was no check on the part of the persons who issued the advertisement, and that it would be an insensate thing to promise £100 to a person who used the smoke ball unless you could check or superintend his manner of using it. The answer to that argument seems to me to be that if a person chooses to make extravagant promises of this kind he probably does so because it pays him to make them, and, if he

has made them, the extravagance of the promises is no reason in law why he should not be bound by them.

It was also said that the contract is made with all the world—that is, with everybody; and that you cannot contract with everybody. It is not a contract made with all the world. There is the fallacy of the argument. It is an offer made to all the world; and why should not an offer be made to all the world which is to ripen into a contract with anybody who comes forward and performs the condition? It is an offer to become liable to any one who, before it is retracted, performs the condition, and although the offer is made to the world, the contract is made with that limited portion of the public who come forward and perform the condition on the faith of the advertisement. It is not like cases in which you offer to negotiate, or you issue advertisements that you have got a stock of books to sell, or houses to let, in which case there is no offer to be bound by any contract. Such advertisements are offers to negotiate—offers to receive offers—offers to chaffer, as, I think, some learned judge in one of the cases has said. If this is an offer to be bound, then it is a contract the moment the persons fulfil the condition. That seems to me to be sense, and it is also the ground on which all these advertisement cases have been decided during the century; and it cannot be put better than in Willes, J.'s judgment in *Spencer v. Harding,* Law Rep. 5 C. P. 561, 563, "In the advertisement cases," he says: "there never was any doubt that the advertisement amounted to a promise to pay the money to the person who first gave information. The difficulty suggested was that it was a contract with all the world. But that, of course, was soon overruled. It was an offer to become liable to any person who before the offer should be retracted should happen to be the person to fulfil the contract, of which the advertisement was an offer or tender. That is not the sort of difficulty which presents itself here. If the circular had gone on, 'and we undertake to sell to the highest bidder,' the reward cases would have applied, and there would have been a good contract in respect of the persons." As soon as the highest bidder presented himself, says Willes, J., the person who was to hold the *vinculum juris* on the other side of the contract was ascertained, and it became settled. . . .

§72. *Communication of Offer.*—An offer is adequately expressed only if it is communicated to the offeree. Let it be supposed that two persons make offers to each other by mail, each acting in ignorance of the other's act, and that these offers cross

each other: this would probably not be regarded as constituting a bargain between them, even if each offer called for an acceptance identically the same as that conveyed in the counter-offer. In support of this conclusion it was said by one judge: "Such grave inconvenience would arise in mercantile business if people could doubt whether there was an acceptance or not that it is desirable to keep to the rule that an offer that has been made should be accepted by an acceptance such as would leave no doubt on the matter."[1]

Offer and acceptance must therefore be conceived of as involving an exchange of assurances. As we shall see later, the expression of the offeree's assent need not actually reach the offeror; on the other hand, however, the element of exchange does require that the offeror's assurance be not only expressed but actually communicated to the offeree.

This principle finds its chief application in those cases which hold that one who makes an offer of a reward does not incur legal liability in favor of a person who has performed the requested services but did so in ignorance of the offer.[2]

The mode of communicating an offer is, of course, left to the discretion of the offeror.

§73. *Termination of an Offer.*—Offers are not usually long-lived. They may come to an end as the result of the initiative of either one of the parties or by an "act of the law."

The offeror may terminate the offer either by (1) setting a time-limit for the duration of the offer, upon expiration of which the offer automatically lapses; or (2) revoking the offer. Inasmuch as the former of these ways of terminating an offer in-

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[1]From the discussion by Blackburn, J. in *Tinn v. Hoffman* (1873) 29 L. T. (n. s.) 271, 279.

[2]A few courts allow the plaintiff to recover in these reward cases. In *Dawkins v. Sappington* (1866) 26 Ind. 199, in which the court sustained an action of this kind, it was said, at page 200: "The liability to pay a reward offered seems to rest, in some cases, upon an anomalous doctrine, constituting an exception to the general rule." If it be thought good policy in the reward cases, to depart from the "general rule" in order to stimulate the activity of citizens in restoring lost property, and in arresting criminals, the appropriate means of reaching this result would seem to be by legislative action.

volves no difficulty so far as the legal phases of the problem are concerned, it may be omitted from further consideration.

Action by the offeree effects a termination of the offer when it amounts to (1) rejection, or (2) counter-offer or modified acceptance.

Termination of an offer by "an act of the law"[1] most commonly is conditioned upon (1) expiration of a reasonable time, in such cases in which the offer is made without a specified time-limit; or (2) death of either the offeror or the offeree.

§74. *Revocation of Offer.*—Ordinarily an offer may be revoked at any time before acceptance. An offer of itself does not involve either the offeror or the offeree in legal liability. The offeror is entitled to withdraw it at any time notwithstanding a previous declaration by him that the offer was to be open for a specified time or for a reasonable time. In most European countries a mere agreement that the offer is to be open for a specified, or for a reasonable time is binding. In our law, however, it is otherwise, because of the rule that a promise must be supported by a consideration, or be made under seal, in order to be enforceable.

§75 *OFFORD v. DAVIES AND ANOTHER*
Common Pleas, 1862. [12 *C. B.* (*n. s.*) 748.]

[The defendants gave a continuing guaranty as follows: "We, the undersigned, in consideration of your discounting, at our request, bills of exchange for Messrs. Davies & Co. hereby jointly and severally guarantee for the space of twelve calendar months the due payment of all such bills of exchange, to the extent of £600." A number of bills were discounted by the plaintiff and duly paid, but before the expiration of the twelve months the defendants countermanded the guaranty. The plaintiff, however, continued to discount bills, and when some of them were not paid, sued the defendants on their guaranty.]

ERLE, C. J.: . . . This promise by itself creates no obligation. It is in effect, conditioned to be binding if the plaintiff

[1] "Where changes are worked in the legal rights and interests of persons by rules of law not dependent on the will of any party, this is often and conveniently said to be an 'act of the law' as contrasted with an 'act of parties,' although the contrast is not logically quite exact." Sir F. Pollock, *First Book of Jurisprudence* (2d ed.), p. 141.

acts upon it, either to the benefit of the defendants or to the detriment of himself. But, until the condition has been at least in part fulfilled, the defendants have the power of revoking it. . . .

§76. *Offer under Seal and Paid Option.*—Although there are opposing decisions on the question, the preponderance of authority holds that if an offer be made under seal (in jurisdictions where the seal has not been abolished) or if consideration be paid for it the offeror is without power to revoke his offer; and acceptance of it, therefore, even after its attempted revocation, results in a contract. Moreover, contrary to the unduly broad generalization sometimes made that equity will not assist a volunteer, specific performance will be granted, when that remedy is otherwise appropriate, even though the offer was gratuitous, provided it was under seal. For a recent decision see *Thomason v. Brewster* (1918), 176 N. Car. 622.

§77 *HOWE SCALE CO. v. WOLFSHAUT.*

Supreme Court, Appellate Term, First Department, New York, 1918. [170 *N. Y. Sup.* 943.]

LEHMAN, J.: It appears that on October 30, 1917, the defendant signed an order for the delivery of a machine made by the plaintiff. The note is an integral part of the order, and is printed at the foot of the blank form of order signed by the defendant. The order is specifically made subject to the approval of the seller of the machine. While it purports to bind the defendant absolutely, and contains the words: "It is expressly agreed that this order shall not be countermanded," it is quite evident that the plaintiff was not bound to accept the order or deliver the machine. The order consequently constitutes merely an offer, and could not ripen into a contract until it had been accepted by the plaintiff, and that acceptance evidenced either by the actual delivery of the machine, or by some other unequivocal act, through which the seller would on its part bind itself to deliver the machine, and thus furnish consideration for the defendant's unilateral promise to pay for the machine. Until the offer was accepted and consideration furnished for the unilateral promise of the defendant, the defendant had a right to withdraw his offer and cancel his promise to pay, even though the order contained the clause that it could not be countermanded. *Hallwood Cash Reg. Co. v. Finnegan* (Sup.),

84 N. Y. Supp. 154; *National Cash Register v. McCann,* 80 Misc. Rep. 165, 140 N. Y. Supp. 916.

In the present case the defendant, on November 3d, notified the plaintiff of its intention to cancel the contract. At that time the plaintiff had not shipped the goods, nor had it notified the defendant that it had accepted his order, although there is testimony to show that the order had been marked O. K. by the sales manager. It is, however, now well established:

"That the mere physical acceptance and attempted enforcement by one party of a contract unilateral in form, and executed by another, does not make the former a party to and bound by the contract." *Levin v. Dietz,* 194 N. Y. 376, 87 N. E. 454, 20 L. R. A. (N. S.) 251.

Under these circumstances, the court was bound to hold as a matter of law, and regardless of any extraneous issue of fraud raised by the pleadings, to dismiss the complaint at the close of the plaintiff's case.

Judgment must therefore be reversed, with $30 costs, and the complaint dismissed, with costs in the court below. All concur.

§78. *Countermanding an Order.*—The countermanding of the order allowed here must, of course, be carefully distinguished from an attempt to cancel an accepted offer. That, contrary to a vague but widespread impression in the business world, cannot be done without the consent of the other party to the agreement. Of course "it is done." In some lines of business a weakness has developed under the pressure of competition, in the direction of assenting to cancellations rather than incurring the displeasure of customers.

§79. *Relief When Hardship is Inflicted on the Offeree by Revocation.*—That revocation of the offer may sometimes cause a hardship to the offeree cannot be doubted. Whenever the offer consists of a promise which is to be binding only upon the performance of a designated act by the offeree, the offeree is involved in an especial risk because of the offeror's freedom to revoke his offer. In such a case there is, of course, no obligation upon the offeree, either to begin performance or to complete performance after beginning it. Likewise, the offeror's promise is not binding upon him because of the mere fact that the offeree has promised to perform, or, indeed, has even begun perform-

ance. The offer remains unaccepted until the offeree has completely performed the requested act, and, hence, until that time, the offer remains revocable, under the doctrine discussed in the preceding section.

It should be observed that the situation under consideration is one in which the offer contemplates the formation of a special kind of contract. The offer is directed to the formation of a "unilateral" contract, that is, a contract with a promise outstanding on one side only. Whenever an offer to a contract stipulates that a return promise by the offeree shall be given by way of an acceptance, the situation is entirely different. The offeror then proposes a "bilateral" contract, that is, a contract which consists of mutual promises. As soon as the offeree gives the requested promise, the offer is accepted, and both parties are bound from that moment provided the mutual promises are sufficient consideration for each other.[1]

But even if the offer is plainly directed to a unilateral contract, a revocation of it does not always leave the offeree without a remedy. If the offeree has begun performance, and the effect of his partial performance has been to enrich the offeror, the latter would be liable in an action of quasi-contract for the amount of his enrichment. If, however, there is no basis for a quasi-contractual recovery, it is not clear upon what principle, if any, the offeree may secure relief. The cases involving this question are not many. In one jurisdiction it has been held that the offeree is without a remedy;[2] on the other hand, a few courts have suggested that the offeree could disregard a revocation made

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[1]As soon as negotiations for a contract have gone far enough to bind one of the parties, both are bound, and neither can thereafter withdraw without the consent of the other. Whether one who is negotiating for a contract should, therefore, strive for unilateral or a bilateral contract, must depend upon his answer to the question, Which is more advantageous to me in this particular situation: to retain my freedom of action until I shall have fully received the desired performance, thereby running the risk which is incident to a similar freedom of action by the other party; or to involve myself by making a binding promise for the sake of securing a corresponding binding engagement from the other party?

As a matter of fact, most of the contracts made by business men are bilateral contracts. In doubtful cases, therefore, courts interpret the offer as an offer to a bilateral, instead of a unilateral contract.

[2]*Biggers v. Owen* (1887), 79 Ga. 658.

after performance was begun by him. There is a similar division of opinion among the textwriters. Some of them are disposed to treat rather lightly the hardship inflicted on the offeree by revocation, on the ground that it is of his own making.[3] On the other hand, in the eyes of Professor Ashley and others, "the harsh results which are possible in this class of cases are revolting to a natural sense of justice."[4]

§80. *When Revocation Takes Effect.*—Revocation of an offer takes effect only from the time it is communicated to the offeree. The modern law relating to agreement is thoroughly objective in character. It does not inquire whether there has been a true "meeting of the minds." With respect to the making of a bargain, the object of investigation by the law is, not the state of mind of an individual, but whether the conduct of the individual conforms to the standard imposed by the law. As regards the revocation of an offer, the standard of conduct to which the offeror is held has been stated as follows: "Knowingly to lead a person reasonably to suppose that you offer and to offer are the same thing. It would be monstrous to allow an inconsistent act of the offeror, not known or brought to the notice of the offeree, to affect the making of the contract."[1]

The rule that revocation of an offer is ineffective until it is brought to the knowledge of the offeree was laid down by the United States Supreme Court in 1850,[2] but did not become settled law in England until 1880.

§81. *BYRNE & CO. v. VAN TIENHOVEN & CO.*
Common Pleas, 1880. [5 *C. P. Div.* 344.]

[Offer to sell goods was sent by defendants from England on October 1st, received by plaintiffs in New York on October 11th, and accepted by cable on the same day. On October 8th de-

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[3]Langdell, *Summary of the Law of Contracts*, sec. 4.

[4]Various suggestions have been advanced by these writers as a solution of the difficulty. See Ashley, *The Law of Contracts*, §30, and the article by D. O. McGovney, *Irrevocable Offers*, 27 Harv. L. Rev. 644, especially pp. 654-663.

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[1]*Brauer v. Shaw* (1897), 168 Mass. 198, 200, per Holmes, J.

[2]*Tayloe v. Merchants' Fire Ins. Co.* (1850), 9 How. (U. S.) 390.

fendants mailed a letter withdrawing the offer. The letter of revocation did not reach plaintiffs until October 20th.]

LINDLEY, J.: . . . A state of mind not notified cannot be regarded in dealings between man and man, and . . . an uncommunicated revocation is for all practical purposes and in point of law no revocation at all . . . I pass, therefore, to the next question, whether posting the letter of revocation was a sufficient communication of it to the plaintiff. . . . In this particular case I can find no evidence of any authority in fact given by the plaintiffs to the defendants to notify a withdrawal of their offer by merely posting a letter. . . .

§82 *DICKINSON v. DODDS.*

Court of Appeal, 1876. [2 *Ch. Div.* 463.]

[Defendant offered in writing to sell a certain house to the plaintiff, adding that the offer was to be "left over" until a time named. In the course of the next day the plaintiff heard from his agent that the defendant had been offering or agreeing to sell the property to another person. Nevertheless, early on the following morning the plaintiff formally accepted the offer before the prescribed time had elapsed. The defendant contended that the acceptance came too late as he had sold the property. It was held by the Court that knowledge in point of fact of the offeror's changed intention, however it reached the other party, will make the offeror's conduct a sufficient revocation.]

§83. *Indirect Communication of Revocation.*—If the mail be used in revoking an offer, it would probably be held that the physical fact of a delivery of the letter by the postman into the addressee's possession would be decisive on the question of communication.[1]

Revocation may, of course, be communicated by the conduct of the offeror as well as by his words. For example, a revocation would be accomplished if the offeror, after offering to sell a specific object, should, in the presence of the offeree, sell the article to a third person.

It is quite a different matter, however, to hold that acceptance cannot be made merely because the offeree learns of the offeror's change of intention through a stranger.

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[1]In California, Montana, and the Dakotas, however, the Civil Codes provide that revocation shall be effective from the time that notice thereof is placed "in course of transmission."

This question only rarely comes up for adjudication. In England the House of Lords has still to pass upon the point. In the three or four states in which our courts have had occasion to consider the doctrine of *Dickinson v. Dodds,* it has met with no adverse criticism. Nevertheless, its soundness is open to some question. Is it not reasonable for the offeree to rely on the offer until he receives notice of its withdrawal from the one who was responsible for the offer's existence? From a practical point of view, is it not a serious objection to the rule of *Dickinson v. Dodds* that the offeree is frequently in the dark as to whether or not the information in his possession is sufficiently plain and reliable to constitute an adequate communication of the offeror's change of mind?

§84. *An Offer Made to the Public May Be Revoked in the Manner in Which It Was Made.*—In general, knowledge of the offeror's change of intention must be actually brought home to the offeree, and merely doing one's best to communicate a revocation of the offer does not therefore constitute a revocation. If, however, an offer is made to the public generally, it is virtually impossible to effect a revocation in accordance with the ordinary rule, and this makes it fitting to lay down a special rule for this special situation.

§85 *SHUEY v. UNITED STATES*

Supreme Court of the United States, 1875. [92 *U. S.* 73.]

[Offer of reward made by advertisement.]

STRONG, J.: The offer of the reward not having been made to him directly, but by means of a published proclamation, he should have known that it could be revoked in the manner in which it was made.

§86. *Termination of Offer by Rejection.*—Just as it is possible for an offeree to express a "grumbling assent," that is, to accept the offer despite an open dissatisfaction with it, so also it is possible for him to grumble at some of the terms of the offer without thereby necessarily rejecting it. But if the offeree plainly rejects the offer, the offeror's responsibility for the offer is ended.

§87. *Termination of Offer by Counter-Offer.*—An offer may be refused in various ways. It does not need to be rejected in so many words. The conduct of the offeree may of itself plainly indicate that he has turned down the offer. Moreover, a counter-offer by the offeree, even though unaccompanied by explicit words rejecting the offer, is held to operate as a declination of the offer.[1]

Not infrequently the offeree accepts, as he calls it, on condition that one term or another of the offer be modified, or that an additional term be added. This, however, is really a counter-offer and, accordingly, constitutes a rejection of the original offer.

A business man should, therefore, realize that if he wishes to retain the privilege of holding the offeror to his offer he must be careful not to make a counter-offer, or to express a modified acceptance. He may, of course, reply in a merely non-commital way without thereby terminating the offer. For instance, he may make an inquiry for more specific information on any point contained in the offer, or he may ask whether the offeror will consent to modify his terms.

§88. *Lapse of Offer.*—The offeror may make his offer in whatever terms he pleases, and hence he may, among other things prescribe a certain time within which the offer must be accepted.[1] Even if he fails to prescribe the maximum duration of his offer, it may die a natural death, as it were.

First, if no time limit is specified, an offer comes to an end after the expiration of a reasonable time. This rule finds its justification in the general principle that in the absence of express stipulations an offer will be given a reasonable interpretation.

What amounts to a reasonable time is a question of fact which depends on the nature of the particular transaction in each

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[1]*Hyde v. Wrench* (1840), 3 Beav. 334. Offer to sell an estate for £1000. The offeree made a counter offer of £950 which was refused. Afterwards, he attempted to accept the original offer. The court held that the counter-offer had terminated the original offer.

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[1]The mention of a maximum time-limit in the offer does not, of course, preclude the offeror from revoking the offer.

case.[2] At one end of the scale are offers on the floor of the stock exchange; at the other end, perhaps, are offers to sell a piece of real estate in the country. In the case of business offers received by mail the offeree's acceptance must, as a rule, be mailed on the same day. When parties are dealing with each other orally, the circumstances often indicate with reasonable plainness that the offer was not to remain open after the close of the interview, during which it was made.

Second, an offer lapses upon the death of either party before acceptance. The reason usually given for this rule is that it takes two persons to enter into an agreement. In truth, however, it might well be held, under the modern conception of what amounts to mutual assent,[3] that the death of the offeror, so long as it is not known to the offeree, should not terminate the offer.

§89. *Requisites of Acceptance.*—An acceptance must comply absolutely with the terms of the offer. The offeror is lord of his offer. Every one of his demands, whether or not it be acceptable to the offeree, must be strictly complied with if there is to be a valid acceptance. If, for example, an offer be made to a particular person it can be accepted only by him, even though the duty of performance after the contract is made may under some conditions be delegated.[1]

§90 *BOULTON v. JONES.*

Exchequer, 1857. [2 *H. & N.* 564.]

[Defendant, who had been in the habit of dealing with one Brocklehurst, sent a written order for goods to him. Brockle-

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[2]In *Phillips v. Moor* (1870), 71 Me. 78, it was stated that "if the party to whom it (the offer) is made, makes known his acceptance of it to the party making it, within any period which he could fairly have supposed to be reasonable, good faith requires the maker, if he intends to retract on account of the delay, to make known that intention promptly." In an Iowa case, however, vigorous dissent was expressed to this doctrine. *Ferrier v. Storer* (1884), 63 Iowa, 484, 487. On principle it would seem that courts should not impose a duty on the offeror to inform the offeree that his acceptance has arrived too late; as a matter of business policy, however, an offeror should not neglect to do this.

[3]See §60 supra.

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[1]*Jordan Marsh Co. v. Beals* (1909), 201 Mass. 163.

hurst had previously sold his stock-in-trade and assigned his business to the plaintiff. Plaintiff supplied the goods ordered by the defendant, without notifying the latter that the business had changed hands, and the defendant did not learn of this until he had consumed the goods.]

MARTIN, B.: . . . If there was any contract at all it was not with the plaintiff. If a man goes to a shop and makes a contract, intending it to be with one particular person, no other person can convert that into a contract with him.[1]

§91. *Control of Offeror Over Mode of Acceptance.*—In the same way it is the privilege of the offeror to stipulate that acceptance be made in a particular place,[1] or to impose any other condition he may choose.

The distinction must be made, however, between a condition in the offer and a mere suggestion as to the manner or form of acceptance. A mere suggestion in the offer may be ignored by the offeree in his acceptance.

The preceding discussion makes it evident that the interpretation of the offer presents the chief difficulty which is encountered in the application of the rule that an acceptance must correspond with the terms of the offer.[2] It is unquestionably sound to say that an offer must be given the interpretation that a reasonable man would give it, but the application of this test to concrete cases frequently occasions no little difficulty.

As additional problems in the construction of offers, consider the two following cases in which the offeror did not himself specify the terms of the bargain with certainty and definiteness, but instead left it to the offeree to do this.

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[1]The defendant had a right of set-off against Brocklehurst, and this fact had a bearing on the question whether the personality of the offeree formed an essential element in the offer.

The principles of quasi contract applicable to the case are discussed in Woodward, *The Law of Quasi Contracts*, §§55-58.

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[1]*Eliason v. Henshaw* (1819), 4 Wheat. 225.

[2]Sometimes, however, it is necessary to decide whether, in the so-called acceptance there is a condition not contained in the offer. If the "acceptance" does contain such a condition, it is worthless as an acceptance, *Seymour v. Armstrong & Kassebaum* (1901). 62 Kans. 720; moreover, it terminates the original offer. See *supra*, §87.

§92 *GREAT NORTHERN RY. CO. v. WITHAM.*

Common Pleas, 1873. [*L. R.* 9 *C. P.* 16.]

[Defendant sent in a tender to the plaintiff as follows: "I, the undersigned, hereby undertake to supply the Great Northern Railway Company, for the twelve months from November 1st, 1871, to October 31st, 1872, with such quantities of each or any of the several articles named in the attached specification as the company's store-keeper may order from time to time, at the price set opposite each article respectively, and agree to abide by the conditions stated on the other side. (Signed) Samuel Witham." The plaintiff's officer wrote in reply as follows: "Mr. Samuel Witham: Sir: I am instructed to inform you that my directors have accepted your tender. . . . The terms of the contract must be strictly adhered to. . . . (Signed) S. Fitch, Assistant Secretary." Several orders were given by the plaintiff and were executed by the defendant, but ultimately the defendant refused to fill certain orders sent by the plaintiff.]

KEATING, J.: . . . But here the company had given the order, and had consequently done something which amounted to a consideration for the defendant's promise.[1]

§93 *CHICAGO, etc. RY. CO. v. DANE et al.*

Court of Appeals of New York, 1870. [43 *N. Y.* 240.]

[Defendants, who were forwarders, made an offer to plaintiff in April for the transportation of not exceeding 6,000 tons of iron. The plaintiff replied that it assented to the agreement and would be bound by its terms.]

GROVER, J.: The counsel for the appellant further insists that the letter of the defendant was a continuing offer, and that the request of the plaintiff, in August, to receive and transport a specified quantity of iron was an acceptance of such offer, and that the promises then became mutually obligatory, if not so before. This position cannot be maintained. Upon receipt of the defendants' letter, the plaintiff was bound to accept in a reasonable time and give notice thereof, or the defendant was no longer bound by the offer.

§94. *Interpretation Based on Offeror's Situation.*—In the Witham case the offer is construed as a continuing offer inas-

[1]The defendant, however, doubtless had it in his power to revoke the offer at any time, and any orders received by him thereafter would not result in imposing an obligation upon him.

much as the offeror was a dealer who regularly had on hand a stock of the offered goods. It is reasonable, therefore, to interpret the offer as requiring nothing more definite and certain in the terms of acceptance than would be indicated in the separate orders sent in by the offeree from time to time.

In the Dane case the offer was construed not as an offer to a series of transactions, but as an offer which contemplated a single bilateral contract, and which required the offeree forthwith to specify the amount of iron which would be tendered for transportation.[1] The soundness of this construction of the offer has often been questioned, but the fact that the offeror was a mere forwarder and not a common carrier is perhaps the most important reason for giving a different construction to the offer from that in the Witham case.

§95. *Acceptance Must Contemplate Legal Relations.*—An acceptance must indicate that the offeree intends to enter into legal relations with the offeror. If the offeree has knowledge of the offer and complies with its terms his conduct, in all ordinary cases, leads to the inference that he intended to enter into legal relations with the offeror. This presumption may be overcome, however, by evidence that the offeree lacked any such intention.

§96 *HEWITT v. ANDERSON et al.*

Supreme Court of California, 1880. [56 *Cal.* 476.]

[Defendants published an offer of reward. The trial court found for the plaintiff in all respects except that he had done none of the acts with a view of obtaining the reward. Judgment was affirmed for the defendants.]

SHARPSTEIN, J.: . . . We are not aware of any case in which it has been held that a party, after disclaiming any intention to claim a reward, could recover it. . . .

§97. *An Acceptance Must Be Expressed by an Overt Act.*—Some outward manifestation of the offeree's intention to accept

[1]In both the *Witham* case and the *Dane* case the so-called "acceptance" made by the offeree upon the receipt of the offer amounted to nothing more than the acceptance of an option for which no consideration was given and which was, therefore, not binding on the offeror. See §§74, 75, *supra*.

the offer must be made before the law is able to take cognizance of that intention. The overt act need not, of course, always consist of words, spoken or written. The fall of a hammer, the sending of goods in response to an order, the delivery of a written instrument, are illustrations of other modes of expressing acceptance which are appropriate under certain circumstances.

Although the manner of indicating agreement is ordinarily left to the unfettered discretion of the parties, there is one situation in which this is not so, inasmuch as the law recognizes that only overt acts have legal significance, silence and failure to act on the part of the offeree do not in general constitute an acceptance. It is, therefore, futile for an offeror to state that, unless he hears from the offeree to the contrary, the latter's acceptance of the offer will be assumed.[1] An offeror is lord of his offer but not of the offeree.

Silence does, however, "give consent" when the offeree has consented in advance to have such an interpretation placed upon his silence and inactivity. This is true, for example, when, in the course of the re-organization or re-adjustment of the finances of an embarrassed corporation, the holders of its securities deposit them with a trust company, or other depositary, under the terms of a written agreement stipulating that depositors who do not withdraw their securities within a designated time after public announcement of the plan of re-organization, will be taken to have assented to the plan. So also it is not uncommon to find in leases of real estate a stipulation that the lease shall, at the option of the lessor, continue for another stated period from the expiration of the term unless the lessee, at least thirty days before the expiration of the original term, notify the lessor in writing to the contrary. A similar provision is frequently found in the contracts between telephone companies and their customers.

The offeree's consent to be bound by a failure to take affirmative action need not be expressed in words, but may be inferred from all the circumstances of the case.

[1] *Royal Ins. Co. v. Beatty* (1888), 119 Pa. St. 6.

§98 *HOBBS v. MASSASOIT WHIP CO.*

Supreme Judicial Court of Massachusetts, 1893. [158 *Mass.* 194.]

[Defendant, a whip manufacturer, had been in the habit of accepting and paying for all eel skins shipped to him by the plaintiff, provided the skins were fit for his purposes. The defendant's conduct, however, did not in fact, amount to a standing offer which would be accepted as soon as skins of the prescribed description were sent to him by the plaintiff. Nevertheless, it was *held* that because of the continuous course of dealing between the parties, mere silence on the part of the defendant coupled with the retention of the skins for an unreasonable time might properly be found by the jury to warrant the plaintiff in assuming that his skins had been accepted, and thus to amount to an acceptance of the plaintiff's offer to sell the skins.]

§99. *When Silence Is Consent.*—It does not follow from this decision that a mere failure by the defendant to return goods which he is under a legal duty to send back to the plaintiff, amounts to an acceptance of the plaintiff's offer. The essential fact in the Hobbs case is the previous course of dealings between the parties from which it is fair to infer the defendant's consent to an arrangement whereby a failure by him to return the goods within a reasonable time should be regarded as his acceptance of the plaintiff's offer to sell them to him.[1]

A word of caution may not be out of place. An offeree may not have consented to an arrangement like that in the Hobbs case, and yet act in such way that his conduct amounts to an acceptance.

If A avails himself of benefits which B confers upon him, knowing as a reasonable man, that B expects payment, a promise by A to pay for the benefits may be inferred (assuming that a refusal of the benefits by A would entail no loss on him). In such a case A, though seemingly in a passive attitude, has really acted, and his conduct constitutes an acceptance. Thus, to give merely one illustration, it has been held that one who continues to receive a newspaper or periodical which is being sent to him,

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[1]A later decision, *Wheeler v. Klaholt* (1901), 178 Mass. 141, is perhaps fairly open to the criticism that it does not sufficiently distinguish between a breach of a duty to return the goods and a breach of a promise to take the goods.

thereby promises to pay for it, even though his subscription has expired. Of course, the inference of a promise from the conduct of the recipient is not so strong if the recipient has never been a subscriber, inasmuch as it is then somewhat doubtful whether the recipient had reason to believe that the publisher expected to claim payment.[2]

§100 *CARLILL v. CARBOLIC SMOKE BALL COMPANY.*[1]

Court of Appeal, 1892. [1893, 1 *Queen's Bench,* 256.]

BOWEN, L. J.: . . . Then it was said that there was no notification of the acceptance of the contract. One cannot doubt that, as an ordinary rule of law, an acceptance of an offer made ought to be notified to the person who makes the offer, in order that the two minds may come together. Unless this is done the two minds may be apart, and there is not that consensus which is necessary according to the English law—I say nothing about the laws of other countries—to make a contract. But there is this clear gloss to be made upon that doctrine, that as notification of acceptance is required for the benefit of the person who makes the offer, the person who makes the offer may dispense with notice to himself if he thinks it desirable to do so, and I suppose there can be no doubt that where a person in an offer made by him to another person, expressly or impliedly intimates a particular mode of acceptance as sufficient to make the bargain binding, it is only necessary for the other person to whom such offer is made to follow the indicated method of acceptance; and if the person making the offer, expressly or impliedly intimates in his offer that it will be sufficient to act on the proposal without communicating acceptance of it to himself, performance of the condition is a sufficient acceptance without notification.

That seems to me to be the principle which lies at the bottom of the acceptance cases, of which two instances are the well-known judgment of Mellish, L. J., in *Harris's Case,* Law Rep. 7 Ch. 587, and the very instructive judgment of Lord Black-

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[2]An addressee who refuses to receive the newspaper from the post is under no liability whatsoever; he has made no promise by conduct, nor has he received a benefit for which he should be made to pay by reason of the equitable principle forbidding "unjust enrichment," nor is he under a duty to see that the newspaper is returned to the publisher.

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[1]For other parts of this case see §§71, 115.

burn in *Brogden v. Metropolitan Ry. Co.,* 2 App. Cas. 666, 691, in which he appears to me to take exactly the line I have indicated.

Now, if that is the law, how are we to find out whether the person who makes the offer does intimate that notification of acceptance will not be necessary in order to constitute a binding bargain? In many cases you look to the offer itself. In many cases you extract from the character of the transaction that notification is not required, and in the advertisement cases it seems to me to follow as an inference to be drawn from the transaction itself that a person is not to notify his acceptance of the offer before he performs the condition, but that if he performs the condition notification is dispensed with. It seems to me that from the point of view of common sense no other idea could be entertained. If I advertise to the world that my dog is lost, and that anybody who brings the dog to a particular place will be paid some money, are all the police or other persons whose business it is to find lost dogs to be expected to sit down and write me a note saying that they accepted my proposal? Why, of course, they at once look after the dog, and as soon as they find the dog they have performed the condition. The essence of the transaction is that the dog should be found, and it is not necessary under such circumstances, as it seems to me, that in order to make the contract binding there should be any notification of acceptance. It follows from the nature of the thing that the performance of the condition is sufficient acceptance without the notification of it, and a person who makes an offer in an advertisement of that kind makes an offer which must be read by the light of that common sense reflection. He does, therefore, in his offer impliedly indicate that he does not require notification of the acceptance of the offer. . . .

§101 *WHITE v. CORLIES and TIFFT.*

Court of Appeals of New York, 1871. [46 *N. Y.* 467.]

[Defendants wrote the following note to the plaintiff: "*Upon an agreement* to finish the fitting up of offices 57 Broadway in two weeks from date, you can begin at once." No reply was sent to this offer, but the plaintiff immediately purchased lumber necessary for the purpose and began work thereon. On the next day the defendants sent a countermand. The judge charged the jury that the plaintiff "had a right to act upon this note and commence the job, *and that was a binding contract between the parties.*"]

FOLGER, J.: In the case in hand, the plaintiff determined to

accept. But a mental determination not indicated by speech, or put in course of indication by act to the other party, is not an acceptance which will bind the other. Nor does an act which, in itself is no indication of an acceptance, become such, because accompanied by an unevinced mental determination. Where the act, uninterpreted by concurrent evidence of the mental purpose accompanying it, is as well referable to one set of facts as another, it is no indication to the other party of an acceptance, and does not operate to hold him to his offer. Conceding that the testimony shows that the plaintiff did resolve to accept this offer, he did no act which indicated an acceptance of it to the defendants. He, a carpenter and builder, purchased stuff for the work. But it was stuff as fit for any other like work. He began work upon the stuff, but as he would have done for any other like work.

§102. *When Notice of Acceptance Is Required.*—If an offer calls for an acceptance other than a counter-promise, notice of acceptance is ordinarily not required. An offer which is directed to the formation of a unilateral contract is a good illustration of an offer which requires the acceptance to consist of either the doing of an act or a forbearance of some kind. *Cf.* the language of Lord Bowen in *Carlill v. Carbolic Smoke Ball Co.*, §100, *supra.*

In certain kinds of unilateral contracts, however, the acceptor is under a duty to notify the offeror that he has performed the requested act. This requirement is applicable only where knowledge of the performance would not promptly come to the offeror. A common case of this kind is an offer which contemplates a continuing guaranty, that is, an offer which is to be accepted from time to time by the giving of credit, or other appropriate action on the part of the offeree.[1]

§103 *BISHOP v. EATON.*

Supreme Judicial Court of Massachusetts, 1894. [161 *Mass.* 496.]

KNOWLTON, J.: If the act is of such a kind that knowledge of it will not quickly come to the promisor, the promisee is bound to give him notice of his acceptance within a reasonable time after doing that which constitutes the acceptance. In such

[1]In a minority of states, however, the acceptor is under no duty to give notice that he has given credit as requested.

a case it is implied in the offer that, to complete the contract, notice shall be given with due diligence, so that the promisor may know that a contract has been made. But where the promise is in consideration of an act to be done, it becomes binding upon the doing of the act so far that the promisee cannot be affected by a subsequent withdrawal of it, if within a reasonable time afterward he notifies the promisor. . . . What kind of a notice is required depends upon the nature of the transaction, the situation of the parties, and the inferences fairly to be drawn from their previous dealings, if any, in regard to the matter. If they are so situated that communication by letter is naturally to be expected, then the deposit of a letter in the mail is all that is necessary.

§104. *Time of Acceptance When Mails Are Used.*—A promise, in order to constitute an offer, must be communicated. Is communication also necessary in order for a promise to operate as an acceptance? When two persons are in each other's presence, any unambiguous words or conduct by the offeree expressive of a promise by him comes instantly to the notice of the offeror. For this reason it is only when the parties have negotiated with each other from a distance that the courts are called upon to deal with the question, may anything short of communication constitute an adequate expression of acceptance when the offer calls for a promise by the offeree?

An affirmative answer must be given to this question in at least one situation. "Where the circumstances are such that it must have been within the contemplation of the parties that, according to the ordinary usages of mankind, the post might be used as a means of communicating the acceptance of an offer, the acceptance is complete as soon as it is posted."[1]

If an offeror makes his offer by post it is assumed as a matter of course that he invites an acceptance by post. If, however, the offer is sent by telegraph the offeree is not warranted in using the mail as the medium of acceptance, in the absence of an au-

[1] *Henthorn v. Fraser* (1892), 2 Ch. 27. 33, per Lord Herschell.
This is settled law in this country as well as in England. In Massachusetts it was at one time held that actual communication of the acceptance was necessary before the acceptance would take effect, but it is fairly certain that at the present time the courts in that State would follow the orthodox rule.

thorization to that effect in the offer.[2] That is, the medium of communication of the offer fixes presumptively the medium for the transmission of the acceptance.

The rule applies only when there is no abnormal risk of delay in the transmission of the mails; for instance, it does not apply when postal communication is deranged by war, or when the offeree fails to stamp his letter, or addresses it with misleading inaccuracy.

§105. *Soundness of "Acceptance on Mailing" Doctrine.*—The soundness of the "acceptance on mailing" doctrine has been much debated. It must be conceded that it sometimes inflicts no inconsiderable hardship on the offeror. This is evident, for instance, when the letter of acceptance is lost by the postal authorities.[1] Moreover the postal regulations of the United States which permit the recall of matter deposited in the post office[2] make the offeror's position still more unfavorable. The offeror is bound from the moment the letter of acceptance is posted, although the acceptor still has an interval thereafter during which he may regain the letter of acceptance. It is further true that in the United States a mail carrier is authorized to act as a receiver of mail, and this provides another possibility whereby an offeree may retain for himself a period in which he is practically free although the offeror is bound.[3]

But even from the acceptor's point of view, the existing rule does not always operate satisfactorily. Unless the acceptor actually succeeds in securing possession of his letter of acceptance after posting it, it is beyond his power to nullify the effect of it

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[2]Whenever the offeree is warranted in using the telegraph as the means of communicating acceptance, and the telegraph is used, the acceptance dates from the delivery of the message to the telegraph office.

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[1]It is held that an acceptance is timed from the posting of a letter of acceptance even though the letter never reaches its destination. *Household Ins. Co. v. Grant* (1879), 4 Ex. Div. 216.

[2]Postal Laws and Regulation of 1913, §§552 and 553.

[3]An offeror is frequently so situated that prudence requires him to protect himself by making his offer subject to express conditions. Among other things, therefore, a prudent offeror will not only specify a time limit for acceptance, but will also explicitly demand a safe and timely arrival of the letter of acceptance.

even by a telegram which is shown to have reached the offeror before the letter of acceptance.

On the part of the textwriters there is, generally speaking, little disposition to challenge the proposition that communication is essential to an adequate expression of a promise in all cases except those in which the offeree may reasonably infer from the offer that communication is not essential to the validity of the acceptance. There is, however, no little difference of opinion on the particular question whether an offer which contemplates the use of the mail by the acceptor is fairly to be interpreted as one which impliedly dispenses with the requirement of communication.

To what extent the decisions proceed from the notion that communication is normally of the essence of a promise is somewhat problematical. As a matter of fact, the rules on the subject of acceptance of offers seem to have been developed in a rather empirical way. Moreover, the only situation for which a subordinate rule as to what constitutes a sufficient acceptance has been worked out in the decisions, is the case of an acceptance sent through the post. In all other situations the courts are apparently satisfied to apply to each particular case, the one underlying general principle, which is: "Has the acceptor done an overt act manifesting an intention to bind himself, and is that act one which, according to the ordinary usages of mankind, or according to the course of dealing between the parties, the offeror must have contemplated as an acceptance?"[4]

PRACTICE PROBLEMS

(a) A, the owner of a building, received a letter from B in which B proposed to lease A's building for ten years at $5,000 per month, provided A should undertake to make alterations according to plans "to be mutually agreed upon." A wishes to know from you whether

[4]See Harriman on *Contracts* (2nd ed.), §158.

A general proposition of this kind, of course, makes the decision of each concrete case depend on the inferences which are drawn from its own peculiar facts. So far as the frequently recurring situation of acceptance by post is concerned, there is no serious difference of opinion as to the expediency of crystallizing the issue of fact into a rule of law, although there is much disagreement as to the soundness of the prevailing rule.

an acceptance by him of B's proposal would constitute a contract for a lease.

(b) A builder contracted with the owner of a summer house to wainscot certain rooms in the house for a specified sum. The work was done while the owner was abroad. After wainscoting the rooms the builder without instructions kalsomined the ceilings of the rooms, supposing that the owner would gladly pay a reasonable sum for the additional work. Just as the work was finished a forest near the house took fire and the builder and ten men whom he had hired and paid for the purpose spent ten hours in fighting the fire, thereby saving the house. What, if any, are the builder's rights?

(c) The plaintiff, a builder, before bidding for a construction contract, submitted the plans and specifications to the defendant for an estimate as to the price on the metal work required. After consideration the defendant wrote that he would do the metal work for $5,000. Relying on this assurance, the plaintiff put in a bid which was accepted. Thereupon the plaintiff telephoned the defendant that he was prepared to enter into a written agreement with him for the metal work on the terms of the defendant's letter, and the defendant answered: "All right." Later the defendant refused to sign such a written contract, and the plaintiff had to pay a third party a higher price in order to get the metal work done. Has the plaintiff a cause of action against the defendant? See *Donnelly v. The Currie Hardware Co.* (1901), 66 N. J. Law 388.

(d) A made an offer to B stating that the offer was to remain open until May 15. On May 15, B wrote A requesting that the offer remain in force a week longer. On May 16, A sent a reply assenting to B's request. On the same day while A's letter was still in the mail B posted a letter of acceptance. After receiving A's letter, B states the facts to you. What would be your advice to him?

(e) At B's request, G mailed a letter to S on July 1, promising to guarantee the payment of all goods sold by S to B before December 31. This letter would ordinarily have reached S on the following day, but was not in fact delivered to S until July 3d. On July 2d, G sent S a second letter revoking his previous promise and this letter was duly received on July 3d. S had sold B goods on July 2d and again sold him goods on July 9th and immediately notified G of these transactions. Afterwards, B failed to pay for any of the goods. Is G under liability to S?

(f) A offered to sell B 10,000 to 15,000 tons of steel rails at $48 per ton, the offer to remain open until May 18. On May 15, B wrote A ordering 8,000 tons. On May 16, B wrote A ordering an additional 3,000 tons. Both of B's letters reached A on the same mail on May 17. A paid no attention to these letters for a week. Then

he wrote that he considered himself under no liability. Steel rails having risen in price, B now sues A. What result?

(g) It was mutually agreed between A and B that A was to sell and B to buy at a specified price all the ice that B should need in his business for one year. After six months A secretly sold his business to C who continued to supply B with ice. Three months after the sale of A's business to C, B learned for the first time that C had been supplying him with ice, but he raised no objections and continued to accept the ice from him for one month. Thereafter finding it possible to obtain ice more cheaply elsewhere, B ordered C to discontinue his deliveries to him. B has paid only for the ice delivered during the first six months. What are C's rights against him?

(h) A, having received an offer by mail, wrote out a letter of acceptance and then read both letters to several associates in his office. While his letter of acceptance was in the possession of his messenger boy on his way to the post office, a telegram revoking the offer was received by A. Five minutes after this, A's letter of acceptance was posted, and in due course it reached the offeror. Is there a contract?

(i) G in New York wrote to S in Boston requesting S to sell goods to B on credit and offering to guarantee the payment of B's account to the amount of $1,000. Accordingly, S sold $400 worth of goods to B. S wrote to G notifying him of the transaction but the letter was lost in the mails. Thereafter S sold other goods to B, the amount involved being $500. S neglected to write to G of this sale. Upon B's failure to pay anything S sued G for $900. What should be the result?

(j) A, a cotton broker, received from B, a manufacturer, an order to buy cotton which read: "You can accept this as an order subject to withdrawal before execution." At 10.05 A. M., A purchased cotton to fill this order. At 10.10 A. M., A received a telegram from B dispatched at 9.30 A. M., withdrawing the offer. At 10.15 A. M., A wired B his acceptance of the offer. Was a binding contract made between the parties? See *Weld & Co. v. Victory Mfg. Co.*, 205 Fed. Rep. 770.

(k) A, who lives in the same city with B, made an offer to B in a letter delivered by hand. On the next day, at the same hour, each of them posted a letter, A's letter being one of revocation and B's one of acceptance of the offer. A's letter was received by B before B's letter reached A. Has A's offer been accepted?

(l) A offered in writing to sell B an automobile, the offer to remain open until June 20. On June 1, A wrote B: "I shall be out of the city for some days, and so if you decide at any time to buy my machine, go to my garage and take the car yourself." On June 10, B went to the garage and took out the automobile, but on June 11

he changed his mind and returned the machine. On June 12, A wrote B a revocation of his offer, not having heard of B's action on June 10. Subsequently A discovered the facts and his circumstances have changed so that he wishes to compel B to take the automobile at the price mentioned in his original offer. What are the rights of the parties?

(m) A, by letter, offered to sell his automobile to B for $500. Upon receipt of the offer B immediately mailed an acceptance. While B's letter was on its way, A telegraphed a revocation, and the revocation arrived before the letter of acceptance. B was entirely satisfied with the turn the deal had taken, and bought another second-hand automobile at what he thought was a better bargain than A had offered. Later A found it impossible to dispose of his automobile and he now insists upon holding B to his acceptance. Judgment for whom?

(n) A offered in writing to sell a piece of real estate to B, the offer to remain open until May 20. B, on May 18, wrote a letter of acceptance and posted it. The letter was lost in the mails, and on May 25, A sold and conveyed the land to C. On May 27, A and C learn for the first time of B's letter of May 18. What are the rights of the parties?

B. Consideration.

§106 *RANN v. HUGHES.*

House of Lords, 1778. [7 *T. R.* 350.]

SKYNNER, Ch. B.: It is undoubtedly true that every man is, by the law of nature, bound to fulfill his engagements. It is equally true that the law of this country supplies no means, nor affords any remedy, to compel the performance of an agreement made without sufficient consideration. Such agreement is *nudum pactum, ex quo non oritur actio;* and whatsoever may be the sense of this maxim in the civil law, it is in the last-mentioned sense only that it is to be understood in our law. The declaration states that the defendant, being indebted as administratrix, promised to pay when requested; and the judgment is against the defendant generally. The being indebted is of itself a sufficient consideration to ground a promise; but the promise must be coextensive with the consideration, unless some particular consideration of fact can be found here to warrant the extension of it against the defendant in her own capacity. If a person indebted in one right, in consideration of forbearance for a particular time, promises to pay in another right, this convenience will be a sufficient consideration to warrant an action against him or her in the latter right; but here no sufficient consideration occurs to support this demand against her in her

personal capacity, for she derives no advantage or convenience from the promise here made. For if I promise generally to pay upon request what I was liable to pay upon request in another right, I derive no advantage or convenience from this promise, and therefore there is not sufficient consideration for it. But it is said that if this promise is in writing, that takes away the necessity of a consideration, and obviates the objection of *nudum pactum,* for that cannot be where the promise is put in writing; and that, if it were necessary to support the promise that it should be in writing, it will, after verdict, be presumed that it was in writing; and this last is certainly true; but that there cannot be *nudum pactum* in writing, whatever may be the rule of the civil law, there is certainly none such in the law of England. His Lordship observed, upon the doctrine of *nudum pactum* delivered by Mr. J. Wilmot in the case of *Pillans v. Van Mierop and Hopkins,* 3 Burr. 1663, that he contradicted himself, and was also contradicted by Vinnius in his comment on Justinian.

All contracts are by the laws of England distinguished into agreements by specialty, and agreements by parol; nor is there any such third class, as some of the counsel have endeavored to maintain as contracts in writing. If they be merely written and not specialties, they are parol, and a consideration must be proved. But it is said that the Statute of Frauds has taken away the necessity of any consideration in this case: the Statute of Frauds was made for the relief of personal representatives and others, and did not intend to charge them further than by common law they were chargeable. His Lordship here read those sections of that statute which relate to the present subject. He observed that the words were merely negative, and that executors and administrators should not be liable out of their own estates, unless the agreement upon which the action was brought, or some memorandum thereof, was in writing and signed by the party. But this does not prove that the agreement was still not liable to be tried and judged of as all other agreements merely in writing are by the common law, and does not prove the converse of the proposition, that when in writing the party must be at all events liable. He here observed upon the case of *Pillans v. Van Mierop,* in Burr., and the case of *Losh v. Williamson,* Mich. 16 G. 3, in B. R.; and so far as these cases went on the doctrine of *nudum pactum,* he seemed to intimate that they were erroneous. He said that all his brothers concurred with him that in this case there was not a sufficient consideration to support this demand as a personal demand against the defendant, and that its being now supposed to have been in writing makes no difference.

The consequence of which is that the question put to us must be answered in the negative.

And the judgment in the Exchequer Chamber was affirmed.

§107. *The Development of the Theory of Consideration.*—In the case of *Pillans v. Van Mierop,* cited above, the necessity for a consideration in a written contract was questioned by Lord Mansfield and his colleague, Wilmot. The case in the text fixed the necessity of consideration in all contracts not under seal. If we bear in mind the fact that the doctrine of consideration has come into our law from several distinct sources, some of which, at least, are based purely on procedural accidents, it is easy to see how the question of the necessity of consideration was still an open one at the end of the eighteenth century, though nothing in our law was more settled than the doctrine of consideration in the nineteenth century. The process of merging all of the elements that go to make up the modern concept of consideration, as well as the process of merging several branches of eighteenth century law into the nineteenth century branch of contracts (as illustrated in Jenks' *Introduction to the Digest of English Civil Law,* Book II, Part I.), was influenced largely by business analogies. In business law, the almost universal practice is to require a consideration (or price) in order to make a binding contract. For this reason many of the most difficult questions in the law of contracts as to what is and what is not a consideration are only of casual and indirect interest to the business law student.

§108. *From William Herbert Page. The Law of Contracts,* second edition, Vol. 1, p. 1141: "*Present Standing of the Doctrine of Consideration.*—If we judge by numerical authority, the doctrine of consideration is now thoroughly entrenched in our law. It has been sharply criticized by legal essayists as being indefinite in its application and as resting on bases which are purely historical. We find, furthermore, that the same courts which repeat the doctrine that consideration is necessary are constantly fighting against the consequences which would naturally flow from the doctrine which they repeat so frequently in *obiter.* In the attempts to find a considera-

tion in an act or forbearance which is not agreed upon by the parties, in the cases that enforce a contract on the doctrine of estoppel without any consideration in the proper sense of the term, in the systematic and untiring attempts of the courts to find a technical consideration to support a promise which has no genuine consideration, in the willingness of the courts to enforce contracts, the consideration for which is entirely inadequate, or which is purely nominal, in the determination of many courts to make the recital of a consideration conclusive as to the validity and enforceability of the contract, we can see that courts which repeat in their formulae the doctrine of consideration are rendering mere lip service to a doctrine whose applications and consequences they dislike. It is possibly true that consideration rests primarily upon an historical basis, although the idea of necessity of something of value on each side of every transaction seems to have existed in English law long before the rise of the action of *assumpsit*.

If we may judge by analogy to Roman law, the development in our law will be towards the enforcement of all promises which are made deliberately and fairly, and which are free from mistake, fraud, duress, and the like. Whether our courts develop in this direction or not, and whether the legislature comes to their relief or not, they should, at least, cease juggling the facts of the cases and perverting the intention of the parties, in order to find a technical, nominal, or fictitious consideration, and thus to enforce the promise in question. They should either insist upon the necessity of a real and substantial consideration for every promise, or they should face the necessity of following the civil law in enforcing every fair and deliberate promise, irrespective of consideration.[1]

§109. *From Markby: Elements of Law.*—"Section 633.—It is therefore clear that consideration has nothing whatever to

[1]See "*Is the Doctrine of Consideration Senseless and Illogical?*" by Henry Winthrop Ballantine.—11 Michigan Law Review, 423; for the Civil Law theory see *Consideration v. Causa in Roman and American Law*, Joseph H. Drake, 4 Michigan Law Review, 19; *Nudum Pactum in Roman-Dutch Law*, 9 Journal of Comparative Legislation, (N. S.) 84. [See also Ernest G. Lorenzen, *Causa and Consideration in the Law of Contracts*, 28 Yale Law J. 621.]

do with the question whether or no the promise is gratuitous. A promise may be purely gratuitous, and yet, being based upon a merely nominal consideration, may give rise to liability.

Section 635. I think that the real explanation is manifestly this:—When a man takes the trouble to throw his promise either into the form of a deed under seal or into the form of a bargain for something to be received as a *quid pro quo,* it is only reasonable to conclude that he had some object in doing so; and it is only reasonable to conclude that the object was to show that his promise was not mere talk, but a matter of business; and that the promisor contemplated a legal result, that he should be legally liable to fulfill his promise.

Section 636. When, on the other hand, a man merely makes a promise of future bounty in a casual way it is not at all probable that he intends to subject himself to a legal claim.

Section 637. Where, therefore, the English law seems to me to have gone wrong is not in treating the question of consideration as of importance, but in not recognizing its true value and significance.

Section 638. [Referring to *Shadwell v. Shadwell,* 9 C. B. N. S., 159] . . . The mere promise of B to A that he would marry X, being a promise by B to do something to which he was already bound, was, in accordance with numerous decisions, held to be not a consideration, and the most ingenious suggestions were made to show how it might in this particular case have become so. It would have been much simpler, more in accordance with the facts, and, I venture to think, more reasonable, to hold that the case was one in which legal liability was clearly contemplated by the parties, and liability ought therefore to be enforced."

§110. *Consideration in Modern Business.*—The place of the doctrine of consideration in business is a little different from its place in the law of promises in general. Even in Roman law, where the doctrine of consideration does not prevail in ordinary affairs, in business transactions it has been found necessary to draw a line between a more or less reasonable price and a price

so inadequate as to constitute *laesio enormis.*[1] In the various countries in which Roman law prevails there is no agreement as to where this line of *laesio enormis* shall be drawn, whether it be at one-half the market value or seven-twelfths or more. In Anglo-American law, though, on the one side the *quid pro quo* of business pervades the whole law of contracts, on the other hand, in business itself the idea of price is so far lost sight of that there is no doctrine to correspond to *laesio enormis.* Inadequacy of consideration is, therefore, of interest solely as a badge of fraud or evidence of mistake or for some other secondary purpose, and not as a means in itself of vitiating the contract, except in those cases where the consideration "measures itself" against the promise, as when both are expressed simply in money terms.

§111 *SHEPARD & CO. v. RHODES.*

Supreme Court of Rhode Island, 1863. [7 *R. I.* 470.]

BULLOCK, J.: . . . But the plaintiffs aver an additional consideration for the defendants' promise, and this raises another question: because the former consideration not being illegal, but only insufficient, the latter may sustain the promise declared upon. This additional consideration is *one* dollar, for which, it is alleged, the defendants promised, etc., to pay a sum greater than $1,000.

Ordinarily, courts do not go into the question of *equality* or *inequality* of considerations, but act upon the presumption that parties capable to contract are capable, as well, of regulating the terms of their contracts, granting relief only when the inequality is shown to have arisen from *mistake, misrepresentation,* or fraud. A different rule would, in every case, impose upon the court the necessity of enquiring into and of determining the value of the property received by the party giving the promise. Such a course is obviously impracticable. In all cases, therefore, where the *assumption* or undertaking is founded upon the sale or exchange of merchandise or property, or upon *other than a money* consideration, and the promise has been deliberately made, the law looks no further than to see that the obligation rests upon *a* consideration; that is, one recognized as legal and of *some* value. But the reason of the rule ceases, and, hence,

[1] *I. e.* a manifestly unfair bargain.

the rule ceases, when applied to contracts to pay money and founded solely upon a *money* consideration. How far a forbearance to sue, or the giving of time, or the mere waiver of some right, may support a promise we do not consider, since the question does not arise. Nor, for the like reason, do we consider how far the rule is qualified or limited by special statutes regulating *interest;* or in that class of contracts peculiar to the *law merchant,* as *bottomry, respondentia,* and the course of *exchange.* Aside from these and some other exceptions, at common law a contract for the exchange of *unequal* sums of money at the same time, or at different times, when the element of time is no equivalent, is not binding; and, in such cases, courts may and do enquire into the equality of the contract; for its subject-matter upon both sides has not only a fixed value but is itself the standard of all values; and so, for the difference of value, there is no consideration. In this principle, the earliest prohibitions,—earlier even than the time of Alfred,—and the later legislative enactments against usury, both in England and in this country, have their origin. The rule is deemed to be founded in good policy.

In the case before us, the only *legal* consideration the defendants received was *one* dollar, for which they engaged to pay a much larger sum. The case, therefore, falls within the principle adverted to. The consideration was not only *unequal,* but *grossly* so. It was a mere *nominal* consideration; if even received by the defendants it was, no doubt, regarded as such by them, and intended as such by the promisees. It was, at best, purely *technical* and *colorable, and* obviously is wanting in that degree of equitable equality sufficient to support the promise declared upon.

§112. *"One Dollar" Consideration.*—The "one dollar consideration" is a kind of superstition of our law, indulged in frequently by business men in an effort to be technically correct. Generally it is useless, either because, as in the case before us, it is set off against another sum of money and according to the rule of that case fails to make the necessary consideration, or because it is not actually paid over, and evidence can be introduced to rebut the presumption that what is recited in the paper is correct. In deeds the recital of the payment of a consideration by the grantee serves quite a different purpose, namely, to rebut the rather curious presumption indulged in by the old technical, legal, and equitable rules of real estate that a mere gratuitous

conveyance with nothing to indicate a contrary intention made of the grantee a trustee for the benefit of the grantor rather than absolute owner of the land. The habit of reciting the existence of a consideration in the form of "value received" is without legal significance today in the law of negotiable instruments (*cf.* §320); but when it is held that a statute requires the consideration for a promise of guaranty to be expressed in writing (see §125), it is generally held that "for value received" expresses the consideration sufficiently to satisfy the requirements of the statute.

§113 *WILLIAMS v. CARRINGTON.*

New York County Common Pleas, 1857. [1 *Hilton,* 515.]

The defendant, having made a composition with several of his creditors at forty cents on the dollar, made a similar agreement with the plaintiffs, by which he agreed to pay to the plaintiff forty cents, and did thereupon pay to the plaintiffs the amount of such percentage, and received from them a receipt, purporting to be in full of account. The defendant also, on the day previous, gave a sealed instrument, by which he bound himself to give his note at twelve months for an additional forty per cent., as soon as his compromise should be effected, on condition that the plaintiffs would sign a paper purporting to compromise his indebtedness to them for forty cents. It was never completed, and the plaintiffs now bring this action for the debt due them. . . .

DALY, J.: It was essential, in this case, to show that other creditors had consented to accept the forty per cent. in discharge of their claims in consequence of the plaintiffs' consenting to do so. The consideration which supports such an agreement, when it was not under seal, is the mutual understanding, among all who become parties to it, that each is to take the composition agreed upon, and forbear further to press or insist upon their claims. It is said in *Good v. Cheesman* (2 Barn. & Adolph. 328), by Lord Tenterden, "that a creditor shall not bring an action where others have been induced to *join him* in a composition with the debtor; each party giving the rest reason to believe that, in consequence of such engagement, his demand will not be enforced. This is, in fact, a new agreement, substituted for the original contract with the debtor; the consideration to each creditor being the engagement of the others not to press their individual claims." It must appear that the act of the plaintiff,

in accepting the forty per cent., operated as an inducement to other creditors to do the same, otherwise it is but the acceptance of a lesser sum for a greater, which is no satisfaction. Thus in *Lowe v. Equitar* (7 Price, 604) the plaintiff agreed with the defendant to execute a deed of composition with the other creditors, and to take the benefit of the composition with them, in consideration that the defendant would also deliver to him a picture of the value of £500. The picture was delivered and accepted by the plaintiff in full satisfaction of his claim, and the defendant and all the other creditors, except the plaintiff, signed the composition deed. The plaintiff sued for the original debt, and a plea setting up these facts was held to be no bar. I am inclined to think, from the report of this case, that the picture was accepted in lieu of, or as a payment of the composition, and, if so, it was a case, in its essential features, like the present. Where creditors meet together and the terms of the composition are arranged, as was the case in *Cockshott v. Bennett* (2 Term Rep. 763), or as in *Good v. Cheesman, supra,* put their names to an agreement or memorandum of the term, all the creditors present at such a meeting, or all who sign the writing, enter into a mutual engagement, each with the other, to accept the amount proposed by way of compromise, and to forbear further to insist upon their claims. Where creditors thus mutually agree with each other, the beneficial consideration to each creditor is the engagement of the rest to forbear. A fund is thereby secured for the general advantage of all; and if any one of the parties were allowed afterwards to enforce his whole claim, it would operate to the detriment of the other creditors who have relied upon his agreement to forbear, and might even deprive them of the sum it was mutually agreed they should receive, by putting it out of the power of the debtor to carry out the composition. I know of no case, however, in which an acceptance, by a creditor from his debtor, of a certain sum in discharge of his debt, where other creditors have done the same, has been held to be a satisfaction, unless there was something in the case to show that the other creditors acted with the knowledge of his concurrence, and it could be assumed that their agreement necessarily contemplated and was founded in the benefit and advantage to be derived from his agreement also to forbear—in the language of Lord Tenterden, that they "were induced to join him in the composition." It is very probable, in this case, that such was the fact—very probable that the plaintiffs signed the composition, but nothing of the kind appears in the evidence. For all that appears in the testimony, the other creditors may have accepted the forty per cent. without knowing that the plaintiffs had received that

sum, or had agreed to accept it. We would not be justified in presuming, upon this evidence, that they did, against what must be regarded as a direct finding by the judge below, that they did not. We would have to hold that the judgment he gave was against evidence, and we could not, I think, go to that length.

The judgment must be affirmed; but as the question is not very fully discussed by either party upon the written argument submitted, and as it is of a good deal of practical importance, I think the defendant should be allowed, if he wishes it, to carry the case to the Court of Appeals.[1]

Judgment affirmed.

§114. *Consideration in Compositions.*—This case will be referred to again in connection with the relation of debtor and creditor,[1] but may be considered here as throwing light on the nature of consideration in contract. Strictly speaking, in a case of composition of this kind, there is no consideration passing between the debtor and creditor to support the promise of release of a part of the debt. The law has long clung to the concept that the payment of a sum of money is no consideration for the release of an obligation to pay a larger sum, in spite of the fact that, as a business proposition, an immediate payment of part of a bad debt seems to be an ample consideration for the release of the whole of it. Gradually the courts, without yielding their theory as a whole, have subjected it to numerous exceptions. For example: where the debtor is at the point of bankruptcy, or where the debt is paid in something other than money, (such as a negotiable instrument), or before it is due, or at a different place, or where, as in this case, other creditors come in and the essentials of an agreement can be worked out among them, courts have become astute to uphold the release.

§115 *CARLILL v. CARBOLIC SMOKE BALL COMPANY.*

Court of Appeal, 1892. [1893, 1 *Queen's Bench*, 256.]

BOWEN, L. J.: A further argument for the defendants was that this was a *nudum pactum*—that there was no consideration

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[1]The case was not carried to the Court of Appeals, but Daly, J.'s opinion is quoted with approval by that court in *White v. Kuntz* (1887), 107 N. Y. 524.

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[1]In §265 *infra*.

for the promise—that taking the influenza was only a condition, and that the using the smoke ball was only a condition, and that there was no consideration at all; in fact, that there was no request, express or implied, to use the smoke ball. Now, I will not enter into an elaborate discussion upon the law as to requests in this kind of contracts. I will simply refer to *Victors v. Davies* (12 M. & W., 758), and Serjeant Manning's note to *Fisher v. Pyne* (1 M. & G., 265), which everybody ought to read who wishes to embark in this controversy. The short answer, to abstain from academical discussion, is, it seems to me, that there is here a request to use involved in the offer. Then as to the alleged want of consideration. The definition of "consideration" given in Selwyn's *Nisi Prius*, 8th ed., p. 47, which is cited and adopted by Tindal, C. J., in the case of *Laythoarp v. Bryant*, 3 Scott (p. 238, 250), is this "Any act of the plaintiff from which the defendant derives a benefit or advantage, or any labour, detriment, or inconvenience sustained by the plaintiff, provided such act is performed or such inconvenience suffered by the plaintiff, with the consent, either express or implied, of the defendant." Can it be said here that if the person who reads this advertisement applies thrice daily, for such time as may seem to him tolerable, the carbolic smoke ball to his nostrils for a whole fortnight, he is doing nothing at all—that it is a mere act which is not to count towards consideration to support a promise (for the law does not require us to measure the adequacy of the consideration)? Inconvenience sustained by one party at the request of the other is enough to create a consideration. I think, therefore, that it is consideration enough that the plaintiff took the trouble of using the smoke ball. But I think also that the defendants received a benefit from this user, for the use of the smoke ball was contemplated by the defendants as being indirectly a benefit to them, because the use of the smoke balls would promote their sale. . . .[1]

§116 *PARROT v. MEXICAN CENTRAL RY. CO., LTD.*

Supreme Judicial Court of Massachusetts, 1911. [207 *Mass.* 184.]

KNOWLTON, C. J.: . . . The defendant contends that there was no consideration for the promise to pay money to the plaintiffs, because they were already bound by the writing to do all that they undertook to do under the oral agreement. As a general proposition, it is settled in this Commonwealth that a promise to pay one for doing that which he was under a

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[1]For other parts of this case see §§71, 100.

prior legal duty to do is not binding for want of a valid consideration. . . . *Warren v. Hodge* (121 Mass., 106). It has often been said that the principle involved is the same that lies at the foundation of the doctrine that a promise to accept or pay a less sum in discharge of a debt for a greater amount is not binding. In connection with the general proposition see also *Cabot v. Haskins* (3 Pick., 83, 92, 93), *Tobey v. Wareham Bank* (13 Met., 440, 449), *Lester v. Palmer* (4 Allen, 145), *Harlow v. Putnam* (124 Mass., 553).

A limitation of the general proposition has been established in Massachusetts, in cases where a plaintiff, having entered into a contract with the defendant to do certain work, refuses to proceed with it, and the defendant, in order to secure to himself actual performance of the work in place of a right to collect damages from the plaintiff, promises to pay him an additional sum. This limitation is not intended to affect the rule that a contract cannot be binding without a consideration; but it rests upon the doctrine that, under these circumstances, there is a new consideration for the promise. *Monroe v. Perkins,* 9 Pick. 298. *Holmes v. Doane,* 9 Cush. 135. . . . *Abbott v. Doane,* 163 Mass. 433, 434, 435. In *Rollins v. Marsh,* 128 Mass. 116, 120, the court said: "The parties had made a contract in writing with which the plaintiff had become dissatisfied, and which she had informed the defendant that she should not fulfill unless the terms were modified. If she had abandoned her contract, he might have made a new arrangement with someone else for the support of his ward, and enforced whatever remedy he had for the breach against the plaintiff. Instead of this, he made a new contract with her, which operated as a rescission of the original agreement." In such a case the new promise is given to secure the performance, in place of an action for damages for not performing, as was pointed out by this court in *Peck v. Requa,* 13 Gray 407, 408.

This limitation in the application of the general rule to such facts is not recognized in England, nor in most of the states in this country. See *Abbott v. Doane,* 163 Mass. 433, 434, 435; Leake, *Con.* (4th Eng. ed.) 434-436; Pollock, *Con.* (7th Eng. ed.) 184-186; Harriman, *Con.* §§117-120; see also 8 Harv. L. Rev. 27; 12 Ibid. 515, 521, 531; 13 Ibid. 519; 17 Ibid. 71. While it is well established in Massachusetts, the doctrine should not be extended beyond the cases to which it is applicable upon the recognized reasons that have been given for it. A majority of the court are of the opinion that it is not applicable to the evidence in this case, and that the defendant is right in this contention that, upon the assumption that the parties were bound

by the written contract, there was no consideration for the new promise of the defendant. . . .

§117 *LINZ v. SCHUCK.*

Court of Appeals of Maryland, 1907. [106 *Md.* 220.]

[The plaintiff, Schuck, was working under a contract for the defendant, Linz. After part performance he refused to go on with the work on account of substantial difficulties not foreseen at the time the contract was made. In order to induce him to continue the work, the defendant promised him additional compensation, which he now refuses to pay.]

BOYD, J.: The principal question in the case is whether the plaintiff was entitled to recover for the additional costs and expenses incurred, by reason of those conditions, on the promise of the appellant to pay for them. The precise question for our consideration is presented by the plaintiff's fifth prayer, which was granted. After referring to the written contract made in April or May, 1903, and the refusal of the plaintiff in June, 1903, to perform and complete said contract, the prayer further submitted to the jury to find whether "said refusal on the part of the plaintiff was induced by *substantial and unforeseen difficulties* in the performance, which would cast upon the plaintiff *additional burden not anticipated by the parties when the contract was made,* and if they further find that after said refusal by the plaintiff, the defendant to induce the plaintiff to resume the work thus abandoned promised him to see him through and to stand the consequences, and that relying upon said promise the plaintiff completed the work, then their verdict may be for the plaintiff," etc. That prayer seems to have followed quite closely the language used in *King v. Duluth, M. & N. Ry. Co.,* 61 Minn. 487 (s. c. 63 N. W. 1105), which case, notwithstanding unfavorable criticism by some writers, in our opinion announces a principle which is not only just and equitable, but is easily reconcilable with the general rule that a promise to do, or actually doing, that which a party to a contract is already under legal obligation to do, is not a valid consideration to support the promise of the other party to the contract to pay additional compensation for such performance. In *King v. Duluth,* after stating that general rule, it is added: "In other words, a promise by one party to a subsisting contract to the opposite party to prevent a breach of the contract on his part is without consideration." The Court then cited *Ayers v. R. R. Co.,* 52 Iowa, 478; *Linginfelder v. Brewing Co.,* 103 Mo. 578; *Vanderbilt v. Schreyer,* 91 N. Y. 392, and other cases, most of which are

among those relied on by the appellant as sustaining and illustrating the general rule which the Supreme Court of Minnesota unhesitatingly and emphatically approved of. Indeed, the Court said that the doctrine of *Monroe v. Perkins,* 9 Pick. 305; *Goebel v. Linn,* 47 Mich. 489; *Rogers v. Rogers,* 139 Mass. 440; *Bryant v. Lord,* 19 Minn. 396, and *Moore v. Locomotive Works,* 14 Mich. 266, *as it is frequently applied,* did not commend itself to their judgment or sense of justice. Those are some of a number of cases which have sustained actions for additional compensation on various theories—some on the ground of waiver, others on the ground that the party for whom the work was done had the election of suing the other party for damages for breach of contract or to make a new contract, and others that it was a modification of the original contract, etc. Chief Justice START, of the Minnesota Court, in the course of the opinion, said: "It is entirely competent for the parties to a contract to modify or waive their rights under it and ingraft new terms upon it, and in such a case the promise of one party is the consideration for that of the other; but where the promise to the one is simply a repetition of a subsisting legal promise there can be no consideration for the promise of the other party, and there is no warrant for inferring that the parties have voluntarily rescinded or modified their contract. But where the party refusing to complete his contract does so by reason of some unforseen and substantial difficulties in the performance of the contract, which were not known or anticipated by the parties when the contract was entered into, and which cast upon him an additional burden not contemplated by the parties, and the opposite party promises him extra pay or benefits if he will complete his contract, and he so promises, the promise to pay is supported by a valid consideration. In such a case the natural inference arising from the transaction, if unmodified by any equitable considerations, is rebutted, and the presumption arises that by the voluntary and mutual promises of the parties their respective rights and obligations under the original contract are waived, and those of the new or modified contract substituted for them. Cases of this character form an exception to the general rule," etc. The opinion then goes on to say that, on the other hand, when there are no unforeseen additional burdens, which make the refusal to perform, unless promised further pay, equitable, and such refusal and promise of extra pay are one transaction, the promise is without consideration and the case is within the general rule. It then holds that what unforseen difficulties and burdens will make the refusal to perform equitable, so as to bring it within the exception to the general rule, must depend upon the facts of each particular case.

We have thus referred to, and quoted from, that case at unusual length because the principles therein announced seem to us to be not only well and clearly stated, but just, and founded on reasons that any court of justice should hesitate to reject, unless they conflict with some binding authority or established rule of law, which in our judgment they do not. When two parties make a contract based on supposed facts, which they afterwards ascertain to be incorrect, and which would not have been entered into by the one party if he had known the actual conditions which the contract required him to meet, not only courts of justice but all right thinking people must believe that the fair course for the other party to the contract to pursue is either to relieve the contractor of going on with his contract or to pay him additional compensation. If the difficulties be unforseen, and such as neither party contemplated, or could have from the appearance of the thing to be dealt with anticipated, it would be an extremely harsh rule of law to hold that there was no legal way of binding the owner of property to fulfill a promise made by him to pay the contractor such additional sum as such unforeseen difficulties cost him. But we do not understand the authorities to sustain such a rule; on the contrary, they hold that the parties can rescind the original contract, and then enter into a new one by which a larger consideration for the same work and materials that were to be done and furnished under the first contract can be validly agreed upon. Persons competent to contract can as validly agree to rescind a contract already made as they could agree to make it originally, but we are met with the contention (which, it must be admitted, is sustained by courts of high authority) that while this is true, yet after a contract is broken by one of the parties the other cannot waive his right to treat it as no longer existing and bind himself to pay more than the original contract called for, unless the original contract is actually rescinded. . . .

In Anson on *Contracts*, 76, after speaking of the well-known case of the sailors not being entitled to recover more than their contracts called for, it is said: "It would have been otherwise if risks had arisen which were not contemplated in the contract. For instance, such a contract as that which the seamen had entered into in the case just cited contains an implied condition that the ship shall be seaworthy." Mr. Brantly on page 70 of *Law of Contracts*, after referring to the other doctrine, says: "But the rule of other cases is that the promise is valid because the promisee is entitled to choose between the risk of being sued for a breach of his contract and the prospect of loss from going on at the original price. It also seems that the new promise of

additional compensation amounts to a novation or a substituted contract. While a contract is executory on both sides, the parties are at liberty to rescind it by substituting a new one in its place."

So, without further citation of authorities, we are of the opinion that the fifth prayer of the plaintiff was properly granted for reasons stated above. . . .

§118. *Agreeing to Do What One Is Bound to Do.*—The situation described in this case is one that commonly arises in building contracts. Strictly speaking, where a party agrees to do that which he is already bound to do, his repetition of an old promise is no consideration to support a new promise by the opposite party. The case is similar to that in which officers of the law undertake to do that which they are by law required to do for additional compensation promised them by an individual. In such cases they cannot recover. Compare *Hogan v. Stophlet* (1899), 179 Ill. 150, and cases therein cited. But in the case of these building contracts, courts have not infrequently attempted in one way or another to support the business sense of the community in favor of allowing additional compensation to be collected where it is promised under exceptional conditions, as illustrated in the Linz case.

§119 *SMITH v. TRIPP.*

Supreme Court of Rhode Island, 1883. [14 *R. I.* 112.]

DURFEE, C. J.: . . . The next question is, Would the liability be a good consideration for the express promise if the promise were made after the year expired? When the year expired the liability expired with it, and therefore the question is whether the liability would avail for a consideration after it had become extinct. Regarding the question simply in its logical aspect, it seems as if a liability which has ceased to exist can no more avail than one which has never begun to exist. There are cases, however, which may be thought to militate against this view. For instance, it has been decided in numerous cases that a debt which has been barred by the statute of limitations or discharged in bankruptcy is nevertheless a good consideration for a new promise to pay it. The principle on which these decisions rest, their *ratio decidendi,* has never been very satisfactorily explained. An obvious peculiarity of the cases, however,

is this: That the old debt or obligation does not come to an end of itself, but is only barred or discharged by a statute operating on it from without; and the more prevalent doctrine is that the statutory limitation or discharge, being introduced for the benefit of the debtor, may be waived by him, and that, when it is waived by the new promise, the old debt or obligation either revives or becomes so far relieved from the operation of the statute that it can enter into the new contract as the consideration of it. In the case at bar there is a difference, for here the liability comes to an end of itself; it expires by its own limitation so that it no longer exists; and therefore it is impossible to see how it can be a good consideration for the promise declared on. Even a debt or obligation which has not come to an end of itself but has been discharged, if voluntarily discharged by the creditor, has been held to be so utterly extinct that it can no longer avail as a consideration for a new promise to pay it. *Shepard & Co. v. Rhodes*, 7 R. I. 470. The statute liability here resembles the contract liability in *Monkman v. Shepherdson*, 11 A. & E. 411. There the contract was a contract for service by the terms of which the servant was to forfeit his wages if he got drunk. He did get drunk, but he claimed that the master exonerated him from the forfeiture and agreed to pay him the wages due and continued to employ him. The court held that the new promise was unavailing, being without consideration.

But it may be urged that though the legal obligation expired with the year, the moral obligation to pay for the land, which the defendant had acquired under the act, still remained and constituted a good consideration for an express promise to pay for it. There are doubtless numerous *dicta*, and some decisions, though they are fewer than is generally supposed, which maintain that a mere moral obligation to pay for benefit received is a good consideration for an express promise to pay for it. The doctrine, however, is not supported by the more authoritative modern decisions. Anson on *Contracts*, 81-95; Chitty on *Contracts*, 52 *et sq.; Shepard & Co. v. Rhodes*, 7 R. I. 470; *East wood v. Kenyon*, 11 A. & E. 438; *Beaumont v. Reeve*, 8 Q. B. 483; *Mills v. Wyman*, 3 Pick. 207; *Cook v. Bradley*, 7 Conn. 57; *Bartholomew v. Jackson*, 20 Johns. Rep. 28; *Ehle v. Judson*, 24 Wend. 97; *Porterfield v. Butler*, 47 Miss. 165. The true doctrine has never been better stated than by Lord Denman in *Beaumont v. Reeve, supra.* "An express promise," he says, "cannot be supported by a consideration from which the law could not imply a promise, except when the express promise does away with a legal suspension or bar of a right of action which, but for such suspension or bar, would be valid." See also *Roscorla v. Thomas,*

3 Q. B. 234. The idea that a promise can be supported by a mere moral obligation, simply because the promise is express, involves a logical inconsistency. What is a moral, as contradistinguished from a legal, obligation? A legal obligation is one which is, or which has been, and but for some legal bar or suspension would still be, capable of enforcement either at law or in equity. A moral obligation is one which either never has been, or which, once having been, has absolutely ceased to be capable of being enforced either at law or in equity. It is only obligatory *in foro conscientiae.* If the person obliged says nothing, he owes nothing at law. How, then, can he become indebted or bound at law by merely uttering a naked promise? The promisor gains nothing, the promisee loses nothing, by such a promise. Where, then, is the consideration for it? We cannot discover any. In the case at bar, the law under which the plaintiff's land was transferred to the city compensated him by the remedy which it afforded. He let the remedy go without improvement. Thereupon the legal obligation of the city to pay him became extinct; not by force of any interposed legal bar or suspension, but by its own natural determination. And we do not see how any mere naked promise of the city, subsequently made by it, can either renovate the old or create a new obligation. Of course, when we say this we do not take into the account any right or equity growing out of any waiver or estoppel or other ground for equitable relief against the city; for the case does not show that any such right or equity exists or is claimed to exist, and it will be time enough for the court to deal with a matter of that kind when, if ever, it is presented.

§120 *HATHORN v. WHEELWRIGHT.*

Supreme Judicial Court of Maine, 1904. [99 *Maine* 351.]

WISWELL, C. J.: Action upon a promissory note for $2,957, by the payee against the maker. This note was a partial renewal of a former one for $3,000, in consideration of which the plaintiff, the payee of the note, sold to the defendant an interest in certain inventions and patent rights. The instrument of sale was, in part, as follows: "In consideration of three thousand dollars to me paid by George Wheelwright, of Bangor, I hereby sell and convey to said Wheelwright eight-twentieths of all my patents and inventions in the Fancy Forging and Ball business as now carried on by me." The instrument contained certain other provisions which need not be here considered.

Among other inventions, either patented or to be patented, which were being used by the plaintiff in his business as de-

scribed in this instrument at the time of this sale, and which were used subsequently to this sale, by a corporation formed by the parties to carry on the same business, was an invention which, in appropriate proceedings in the United States Circuit Court for the District of Maine, was decided by that court to be an infringement upon certain patents belonging to the Simonds Rolling Machine Company, and the corporation formed by these parties, together with its officers, were enjoined by a decree of the Circuit Court from the further use of this invention, and were compelled to account for and pay over the profits previously received.

The fact of this adjudication was shown in evidence as a defense to the suit upon the promissory note given in part therefor. It is well settled that a note given for the sale of an invention which is adjudged to be non-patentable, or for a patent which is void for want of novelty and utility, or from any other cause, is not enforceable. 6 A. & E. Encly. of L., 2d ed., 782, and cases cited. This was early decided in Massachusetts in the case of *Dickinson v. Hall,* 14 Pick. 217, and the same doctrine has been frequently reaffirmed in that state. *Lester v. Palmer,* 4 Allen, 145; *Nash v. Lull,* 102 Mass. 60; *Harlow v. Putnam,* 124 Mass. 553; *Chemical Electric Light, etc., Co. v. Howard,* 148 Mass. 352. The same principle was recognized by our court, although perhaps it was not necessarily involved in the decision of the case, in *Jones v. Burnham,* 67 Maine, 93, in this statement: "It is well settled that a note given in consideration of a sale of a patent, or of an interest in the same, where the patent has been adjudged void for want of novelty, cannot be enforced." In an earlier case in this state, *Elmer v. Pennell,* 40 Maine, 430, it was held that evidence that a patent for which the note in suit was given was void because of an infringement of a prior one, is not admissible until that fact has been determined by a circuit court of the United States. But the correctness of this decision to the effect that this matter must first be adjudicated in a circuit court has been frequently questioned in other jurisdictions, and was overruled by this court in *Carleton v. Bird,* 94 Maine, 182.

We do not understand that the counsel for the plaintiff at all questioned this doctrine, but their answer is, that inasmuch as the note was given for other patent rights and inventions, as well as for other considerations, the defense set up is of a partial failure of consideration only and cannot be shown in reduction of damages. It is true that for a long time a rule prevailed in this state to the effect that a partial failure of title constituted no defense to a suit on a note given for real estate. This doc-

trine became so firmly established and was reiterated in so many decisions of the court that the legislature of this state in 1897 deemed it wise and expedient to abrogate it by legislation which now appears in R. S., c. 84, §40, as follows: "In any proceeding in law or in equity in which the amount due on a promissory note given for the price of land conveyed, is in question, and a total failure of consideration would be a defense, a partial failure of consideration may be shown in reduction of damages." But this rule has never prevailed in this state with respect to a note given for any other consideration. Upon the contrary, we regard it as well settled that such partial failure of consideration can be shown in reduction of damages.

This was early decided in Massachusetts in the case of *Harrington v. Stratton,* 22 Pick. 510, wherein many authorities were examined in support of the two doctrines then existing in the different jurisdictions, and the more liberal one was adopted, that, in order to avoid circuity of action a defendant should be allowed to introduce in evidence a partial failure of consideration, rather than be compelled to resort to a cross action. And even before the decision of this case, Chief Justice Shaw, in the opinion of the court in *Parish v. Stone,* 14 Pick. 198, used this language: "It seems, therefore, very clear, that want of consideration, either total or partial, may always be shown by way of defense; and that it will bar the action, or reduce the damages, from the amount expressed in the bill, as it is found to be total or partial respectively."

This court, in *Herbert v. Ford,* 29 Maine, 546, citing *Harrington v. Stratton* and *Parish v. Stone,* decided that: "In an action upon a note between the original parties a partial failure of consideration, though the amount of it be unliquidated, may be proved by the defendant in mitigation of damage, and the jury, upon the evidence, may determine the amount of the failure." The rule is thus stated, and many cases cited in its support, including the Maine case above referred to, in 4 A. & E. Encyl. of L. 2d ed. 195: "Though some of the earlier cases denied the doctrine, there is now no question, in the light of recent decisions, that a partial failure of consideration is a defense *pro tanto* when such failure is liquidated in amount, or can be definitely ascertained by computation, and it has been expressly held that even though the amount of the failure be unliquidated, it may be shown."

The rule then is this, whenever a promissory note is given for two or more independent considerations and there is a failure of consideration as to one, as where the title to one of the articles sold is not in the vendor at the time of the sale, or where there

is a breach of warranty or a misrepresentation as to quality, for the purpose of avoiding circuity of action, the law will allow the defendant, in an action between the original parties, or between others standing in no better position, to show such partial failure of consideration in reduction of damages.

In this case, as we have seen, one of the inventions sold by the plaintiff to the defendant, and for which the note was given in part, proved to be void because it was an infringement upon former patents; this fact is a defense *pro tanto* to the note. Although the case was reported to the law court for its determination, we do not think that the evidence as to the extent of this partial failure, or as to the injury to the defendant by reason of the fact that this invention proved to be void for want of novelty, is sufficiently definite for us to pass upon that question, the trial of the case having apparently proceeded upon the theory that the result depended upon the question as to whether or not partial failure of consideration could be shown in partial defense of the action. We are therefore of the opinion that the case should be remanded to *nisi prius* for trial upon this question. *So ordered.*

§121. *Failure of Consideration and Absence of Consideration.*—Distinguish between failure of consideration and the absence of consideration. In the latter case, there is no contract; in the former, there is a contract, but any action on it is subject to a defense or mitigation of damages. Both of these cases must be distinguished from a bargain that simply turns out to be a bad bargain because of extraneous circumstances. In dealing with these distinctions, the law follows pretty closely the business sense of the community.

In *Franklin Telegraph Co. v. Harrison* (1892), 145 U. S. 459, HARLAN, J., says:

> It is said that the contract turns out to be a hard one for the telegraph company, and that a court of equity should not aid in its enforcement. It is true that in many adjudged cases, and by numerous text-writers, the general rule is laid down that equity in the exercise of a sound judicial discretion will refuse a decree for specific performance where it would be a great hardship upon one of the parties to grant relief of that character. But this general rule is subject, in its application, to some limitations that arise out of the facts of particular cases.
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> In *Cathcart v. Robinson,* 5 Pet. 264, 271—which was a

suit to enforce the specific performance of a contract for the sale and purchase of land, in which one of the defences was the excessive price for which the land was sold—Chief Justice Marshall, while conceding that excess of price was an ingredient which, associated with others, will contribute to prevent the interference of a court of equity, said: "The value of real property had fallen. Its future fluctuation was matter of speculation. At any rate, this excess of price over value, if the contract be free from imposition, is not in itself sufficient to prevent a decree for a specific performance."

In *Marble Company v. Ripley,* 10 Wall. 339, 356, where the decree required the specific performance of a contract to quarry marble, and was objected to upon the ground that, though supposed to be fair and equal when made, the contract became, by lapse of time, and the operation of unforeseen causes, and changed circumstances, unfair, unreasonable and unconscionable, the court, speaking by Mr. Justice Strong, said: "It may be doubted, however, whether the hardship of the contract is any greater than must have been contemplated when it was made. It is not unconscionable because Ripley obtains a larger profit from it than was at first expected, or because the other party obtains less. Those were contingencies, the possibility of which might have been foreseen. It could not have escaped the thought of the contracting parties that the expense of quarrying might possibly increase, and that the expense of sawing and preparing for market might either increase or diminish in the progress of time. Of this they took their chances. Besides, it is by no means clear that a court of equity will refuse to decree the specific performance of a contract, fair when it was made, but which has become a hard one by the force of subsequent circumstances or changing events." These principles, the court said, must be applicable to contracts "that do not look to completed performance within a defined or reasonable time, but contemplate a continuous performance, extending through an indefinite number of years, or perpetually." Fry on *Specific Performance,* 116, and c. 6.

In Sugden on *Vendors* it is said that a "court of equity does not affect to weigh the actual value, nor to insist upon an equivalent in contracts, where each party has equal competence. When undue advantage is taken, it will not enforce the contract; but it cannot listen to one party

saying that another man would give him more money or better terms than he agreed to take. It may be an improvident contract; but improvidence or inadequacy do not determine a court of equity against decreeing specific performance,'' c. 5, §3, par. 25; *Sullivan v. Jacob,* 1 Molloy, 472, 477. So, in *Lee v. Kirby,* 104 Mass. 420, 428: ''The question of the want of equality and fairness, and of the hardship of the contract, should, as a general rule, be judged of in relation to the time of the contract, and not by subsequent events. We do not intend to say that the court will never pay any attention to hardships produced by a change of circumstances; but certainly the general rule is, that a mere decline in value since the date of the contract is not to be regarded by the court in cases of this nature.'' See also *Revell v. Hussey,* 2 Ball & Beatty, 280, 287; *Paine v. Mellor,* 6 Ves. 349, 352; *Mortimer v. Capper,* 2 Bro. Ch. 156. . . .

PRACTICE PROBLEMS

(a) A, desiring to insure a pleasant vacation to B, his favorite nephew, said to him: "I give you my automobile which is now in London. I wish you to use it in making a month's tour of the British Isles and I hereby undertake on your return to pay the entire expense of such a trip from the time you leave your home until you return to it." B said: "I thank you and accept your gift, and shall spend my vacation in the British Isles in the manner you have suggested." B then sailed for England. While on the voyage he received a message by wireless which stated that A had died and that A's executor refused to be liable for the expense of B's vacation trip. When B arrived in London he found that A's executor had cabled orders that the automobile was not to be delivered to him. What are B's rights?

(b) A creditor offered to accept $650 in satisfaction of a liquidated and undisputed debt due him amounting to $1,000. The creditor was willing to do this partly because of the insolvency of the debtor, and partly because he wished to avoid delay and litigation. The debtor paid the $650 and was given a receipt in full. Advise the creditor as to whether he still has a legal claim for the remaining $350. See the discussion of this problem in the article by Professor Williston on *Consideration in Bilateral Contracts*, 27 Harv. L. Rev. 503, 512-516.

(c) A and B entered into a contract whereby A contracted to remodel a house for B. After beginning work, A encountered substantial difficulties which had not been anticipated by either of the parties. A thereupon refused to continue the work except on B's promise to pay additional compensation. B so promised and A completed the

work. Is B liable to A on his second promise? See the discussion in *King v. Duluth, Missabe, etc., Ry. Co.* (1895), 61 Minn. 482.

(d) A contractor and a railroad company entered into a contract by which the contractor was to build a branch line for the railroad. After beginning the work the contractor discovered that a rise in the price of labor and materials would prevent him from making a profit by performing the contract. A large landowner who would profit by the performance of the contract, after learning that the contractor is about to give up the construction, is disturbed to learn that by the weight of authority in this country a bilateral agreement between B and C by which B promises to do something which he was previously legally bound to do by contract with A, is not a valid contract. How would you advise him to go about it in order to get for himself a binding promise from the contractor that the latter will complete the construction of the branch line?

(e) A and B entered into a written agreement whereby A was to buy of B, and B to sell to A at a certain price all the iron that A might require in his business during the ensuing year. B subsequently refused to sell to A on these terms at A's request and asserts that the contract is void for want of mutuality. Is his contention sound? See *National Furnace Co. v. Keystone Mfg. Co.*, 110 Ill. 427.

(f) B placed an order with S for certain specified goods. The order blank of S which was used on this occasion contained a printed clause which read, "All orders accepted to be delivered to the best of our ability, but will under no circumstances hold ourselves liable for failure to deliver any portion of orders taken, sometimes caused by circumstances over which we have no control." S sent an acceptance of the order. Subsequently B wrote S that he did not consider that there was a binding contract between them and that he would not live up to the agreement. Has S a good cause of action against B?

(g) A owed $700. B asked A for a payment of $100 on account and promised him in case the payment were made, to wait one year for the balance. Thereupon A paid B $100 and, desiring to show his gratitude for B's promise of forbearance, promised B to pay in installments of $10 per month a debt of $300, which he owed B but which had been barred by the Statute of Limitation. B did not receive any of the promised monthly payments and after waiting six months sued A for the balance of $600 due on the one debt and for the whole amount of the other debt. How much, if anything, can he recover? See *Gillingham v. Brown* (1901), 178 Mass. 417.

(h) A, who was the payee of a promissory note, indorsed the note to B, a holder in due course. B failed to present the note for payment at maturity and was later notified by the maker that he was unable to pay the note. B informed A of these facts, and, by appealing to A's sense of business honor, induced A to write on the back of

the note the words, "Waive demand and notice." Afterwards B found that A was unwilling to pay and accordingly he sued A on the above instrument. Can he recover? See *Rindge v. Kimball* (1878), 124 Mass. 209.

C. Formal Requisites of Certain Agreements Within the Statute of Frauds

§122. *In General.*—In most of the business dealings of daily life the observance of formalities is not required in order to make them legally binding. The parties to a bargain may, as a rule, determine for themselves the mode of declaring their intention. Nevertheless, as is known to every experienced person, there are certain transactions in which one's supposed rights are unavailable merely because of a failure to comply with certain prescribed formalities.

As a general rule, requirements as to form owe their origin to legislative interference.[1] The most notable piece of legislation of this kind is the famous Statute of Frauds,[2]—"An Act for the Prevention of Frauds and Perjuries,"—which was enacted by Parliament in 1676.

A discussion of all of the multifarious provisions of this Statute would be beyond the scope of a work like the present. The subsequent comments will be confined to the 4th and the 17th sections of the Statute which relate to certain kinds of agreements, six in number.[3]

The fourth section of the Statute embraces five heterogeneous classes of agreements which are presently to be enumerated, and provides that "no action shall be brought" upon any of these

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[1]The common law, although requiring compliance with a preappointed form for conveyance of land, left parties free to make their agreements in their own way.

In the special case of gratuitous promise the common law requires a writing under seal in order to make the promise binding.

Negotiable instruments have always been required to be in writing and in accordance with certain formal requisites. These requirements originated in the custom of merchants, and are obviously necessary if negotiable paper is to serve as an efficient circulating medium.

[2]29 Car. II., c. 3.

[3]It should perhaps be mentioned, however, that the Statute also contains provisions with regard to the following transactions: the creation and transfer of estates and interests in land, including leases (except leases for a term not exceeding three years from the making thereof); declarations of trust of interest in lands; and wills.

agreements "unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith or some other person thereunto by him lawfully authorized." The 17th section of the Statute which deals with the sale of goods reads as follows: "No contract for the sale of any goods, wares or merchandises for the price of ten pounds sterling, or upwards, shall be allowed to be good, except (1) the buyer shall accept part of the goods so sold and actually receive the same, or (2) give something in earnest to bind the bargain or in part payment, or (3) that some note or memorandum in writing of the said bargain be made and signed by the parties to be charged by such contract, or their agents thereunto lawfully authorized."

The present study contains, first of all, an enumeration of the particular kinds of engagements embraced within these sections of the Statute. Next there follows a treatment of the prescribed formalities, giving particular attention to the requirements of the signed memorandum which operates as a satisfaction of both sections of the Statute. Finally, there is a brief discussion of the effect of failure to comply with the requirements of the Statute.

In whole or in part, the provisions of the Statute of Frauds have been incorporated into the statute law of every state.[4] For this reason the terms of the original English Statute

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[4]Frequently, also, there are statutes requiring a writing in proof of certain transactions which do not come within the purview of the Statute of Frauds. The extent and character of this additional legislation varies greatly from state to state. It is out of the question, in a book of this scope, to do more than give the following catalogue of those transactions which have been more or less affected by this kind of legislation: representations as to the character or credit of another; chattel mortgages; certain contracts between husband and wife; contracts providing for a payment of interest above a certain rate; promises to dispose of property by will in a particular manner; contracts of insurance; waivers by debtors of certain defenses, such as, the Statute of Limitations a discharge under bankruptcy proceedings, and infancy.

Federal laws also require that assignments of copyrights and patents must be in writing.

With respect to building and construction contracts a number of states have enacted special statutes requiring the contract to be recorded and the plans and specifications to be approved by certain public officials before an action for breach of contract can be maintained.

will form the basis of the subsequent discussion. Reference will be made, however, to certain of the more important variations from the original model which exist in some of the American statutes.

§123. *Agreements Within the Statute.*—The Statute of frauds is applicable to six classes of agreements. Of the following six classes of agreements, the first five are included in the 4th section of the original Statute of Frauds, and the last mentioned in the 17th section of that Statute:[1]

> (1) "Any special promise by any executor or administrator to answer damages out of his own estate." Engagements of this kind are not frequently met with in business. By law an executor or administrator is liable in his representative, not in his personal capacity. Even if he promises for a valid consideration to pay a sum out of his own pocket towards the satisfaction of a claim against the estate he represents, the Statute makes his promise unenforceable unless it be evidenced by a signed writing.
>
> (2) "Any special promise to answer for the debt, default, or miscarriage of another person."
>
> (3) "Any agreement made in consideration of marriage." This clause applies to an agreement for a marriage settlement, not to mutual promises to marry.
>
> (4) "Any contract for the sale of lands, tenements, or hereditaments, or any interest in or concerning them."
>
> (5) "Any agreement that is not to be performed within the space of one year from the making thereof." According to the majority of decisions, this clause refers only to an agreement which *by its terms* is incapable of performance within one year from the making thereof.
>
> (6) "Contract for the sale of any goods, wares, or merchandises for the price of ten pounds sterling or upwards."[2]

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[1]The 17th section of the original Statute was superseded in England by the provisions of the Sale of Goods Act. The provisions of the latter Act have been incorporated, with certain minor changes, in the Uniform Sales Act which has been enacted in more than twenty states.

[2]The maximum price mentioned in similar American statutes is not uniform, but frequently the figure is $50. In the Uniform Sales Act the price is fixed at $500. In Ohio it is $2,500.

The substance of Section 17 of the Statute has been enacted in all states except Alabama, Delaware, Kansas, Kentucky, Louisiana, New Mexico, North Carolina, Texas, Virginia, and West Virginia. It is this section, of course, that seems, at first sight, of greatest importance in business.

This particular provision of the Statute has probably protected more fraud than it has prevented. In this class of transactions business ethics is in advance of statutory law, for in the eyes of gentlemen in business the pledged word upon which another relies is sacred.[3] Mr. Justice Stephen, one of the critics of the 17th section of the Statute, has pointed out with much force that this section "sins against several of what ought to be the well-recognized rules of all rational legislation."[4] "In the vast majority of cases," said the same authority, "its operation is simply to enable a man to break a promise with impunity, because he did not write it down with sufficient formality. The cases in which a man of honour would condescend to avail himself of it must, I should think, be very rare indeed. Indeed, I can think of no such case, except indeed the case of deliberate perjury."

§124 *WARNER v. TEXAS & P. RY. CO.*

Supreme Court of the U. S., 1896. [164 *U. S.* 418.]

[Action by Warner upon an oral contract. The railway company had promised for a valid consideration to maintain a switch for Warner's benefit for shipping purposes "so long as he may need it." It was held that this verbal contract was not within the Statute of Frauds, for the reason that it did not appear from the terms of the agreement that it could not be performed within a year. It was held to be immaterial that "the time of its performance was uncertain and might probably extend, and be expected by the parties to extend, and did in fact extend, beyond a year."]

§125. *The "Note or Memorandum" as a Method of Satisfying the Statute.*—A signed writing satisfies the statute if it

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[3]See, for example, the fifth canon of commercial ethics adopted by the National Association of Credit Men.

[4]See an article by Mr. Justice Stephen and Frederick Pollock, *Section Seventeen of the Statute of Frauds*, 1 Law J. Rev. 1.

expresses the substance of the agreement with reasonable certainty. It goes without saying that the parties may satisfy the statutory requirement of a signed writing by preparing and signing a written agreement. But according to the original statute and the statutes in the great majority of American states, it is sufficient if there be any kind of a signed memorandum which contains the terms of the agreement.[1]

The form in which the written evidence is embodied is, however, not without legal consequences of some importance. If the writing is intended by the parties to be a complete and final statement of the whole of the agreement, the ''parol evidence rule'' applies and no evidence extrinsic to the document can be introduced in order either to vary or to contradict the terms of the writing. On the other hand, if the writing takes the form of a mere memorandum of the agreement, evidence extrinsic to the writing will be received for the purpose of showing that the writing is either an inaccurate or incomplete expression of the terms of the agreement, and that it therefore fails to comply with the requirements of the Statute. Moreover, as regards the statutory requirement of a signed writing, it is unnecessary to show that the writing was prepared with a view of supplying statutory evidence of the transaction. For instance, a letter by the buyer of goods to the seller in which the buyer, after stating all the essential terms of the bargain, announced his intention not to accept the goods, has been held to be a sufficient memorandum.[2]

Although no particular kind of writing or form of language is required by the Statute and the statutory writing may range anywhere from a carefully prepared written agreement under seal down to mere hasty notes or memoranda, the writing must, nevertheless, contain all the essential terms of the agreement. It must identify the parties, and describe the subject-matter of the agreement, and disclose the promise which forms the basis of the action. Whether it is also necessary to state the considera-

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[1]In New York and a few other states the statutory requirements with reference to a contract concerning an interest in land calls for a "contract" in writing.

[2]*Bailey v. Sweeting* (1861), 9 C. B. (N. S.) 843.

tion for the promise of the defendant, has proved to be a troublesome question.

With respect to the latter point, a difference in the wording of sections 4 and 17 should be noted. The 17th section which relates to contracts for the sale of goods, requires "a memorandum in writing of the said *bargain.*" These words are interpreted as requiring a statement of the price in the memorandum whenever a price has been agreed upon by the parties, for the price is a material part of the bargain.[3] The language of the 4th section of the Statute requires that "the *agreement* upon which such action shall be brought, or some memorandum or note thereof" shall be embodied in a signed writing. In a famous English case it was ruled that the word "agreement" included all the elements of a valid contract and hence that it is imperative that the writing contain evidence not only of the promise but also of the consideration which is necessary to make the contract valid.[4] In this country some of the courts have dissented from this view and have held that the consideration need not be stated. In a considerable number of states there are special statutes dealing with the question. Some of these statutes require that the consideration must appear in the memorandum. Others make any statement of the consideration unnecessary.[5] In the absence of even an approximately uniform rule, one who is not certain of the local law should realize that he is taking a chance if he is not in possession of a memorandum which discloses, not only the promise of the other party, but also the consideration for his promise.

The essential terms of the undertaking must be expressed in the writing, but a full and detailed description of them is not

[3]Since, however, the memorandum need be no more specific than the bargain, it may omit all mention of the price whenever no price was specified in the bargain (in which case the sale is for a reasonable price).

[4]*Wain v. Warlters* (1804), 5 East 10. In 1856 the Mercantile Law Amendment Act did away with the necessity of stating the consideration in the memorandum in one class of agreements within §4, namely contracts to answer for the debt, default, or miscarriage of another.

[5]Statutory provisions of this type, if not skillfully phrased, are apt to give rise to a fresh crop of difficult problems in statutory interpretation. See, for example, the majority and minority opinions in the case of *Hayes v. Jackson* (1893), 159 Mass. 451.

necessary.[6] All that is required is reasonable particularity and certainty in the description of the terms. For instance, it was held in a leading case[7] that the following memorandum was sufficient:

"Sept. 19, W. W. Goddard,

12 mos.

300 bales S. F. drills .... $7\frac{1}{4}$
100 cases blue, do .... $8\frac{3}{4}$

Credit to commence when ship sails; not after December 1—delivered free of charge for truckage.

The blues, if color satisfactory to purchasers.

R. M. M.
W. W. G."

On the other hand, however, there are a number of decisions involving descriptions of real estate which tend to require greater particularity than would seem to be required for reasonable identification.[8]

§126. *Who Must Sign.*—The writing must be signed by the party to be charged or by his agent.—The writing required by the 4th section of the Statute need be signed only "by the party to be charged," whereas the 17th section requires the writing to be "signed by the parties to be charged by such contract." However, the language of both sections has received the same construction, and it is held by the overwhelming majority of cases that the memorandum is sufficient even though it contains only the signature of the party who is being sued on the agreement.[1] That the Statute may operate to make the agreement enforceable at the option of a plaintiff but not at the instance of the defendant is simply another illustration of how

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[6]For a discussion of the question to what extent extrinsic evidence may be introduced to assist in interpreting documents, see §130 ff., *infra.*

[7]*Salmon Falls Mfg. Co. v. Goddard* (1852), 14 How. (U. S.) 446.

[8]For a case close to the line see *Doherty v. Hill* (1887), 141 Mass. 465.

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[1]A written offer duly signed is a sufficient memorandum to satisfy the Statute even though the offer was accepted only by word of mouth. This result, however, would not be reached in those jurisdictions which have a statute requiring the "contract" to be in writing.

frequently its provisions work unanticipated mischief to one of the parties to the transaction.

The signature need not appear at the end of the document.[2] It may be anywhere, even at the top, if it was intended to constitute a part of the memorandum executed by the defendant.[3] The signature may be printed or stamped or consist of a mark, or of initials.

An agent "thereunto lawfully authorized" may make the required signature for the party to be charged, an express provision to this effect being contained in the 4th and 17th sections of the Statute. The authority to the agent to sign need not be in writing.[4] It not infrequently happens that the same person signs the memorandum in behalf of both parties to the transaction; for instance, an auctioneer frequently does this. The Statute does not explicitly forbid one of the parties to act as the agent of the other for this purpose, but courts have refused to permit the signature to be made in this way.[5] This is an instance in which courts have supplied a gap in the Statute; any other decision would violate its general aim by opening the door to perjured testimony.

Several documents, if properly connected, may be read together in order to collect all the terms of the agreement. Sometimes the full terms of the agreement can be gathered only from reading together several documents, each one of which by itself is lacking in some particular. In such situations the Statute is satisfied only when the papers are connected by physical attachment, or when the defendant's signature appears on one of the documents and that document refers to some other paper which supplies the lacking terms.

There is a sufficient physical attachment whenever two or more papers are pinned together. It is held that a letter and its envelope may be taken together to constitute the memoran-

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[2]It is otherwise if, as in a few states, the Statute requires the note or memorandum to be "subscribed."

[3]*Evans v. Hoard* (1892), I Q. B. 593.

[4]A few states, however, have statutes which expressly require the agent's authority to be in writing. An agent's authority to execute a deed, however, can be given only by deed.

[5]*Wright v. Dannah* (1809), 2 Camp. 203.

dum required.[1] In one case the paper signed by the defendant lacked the name of the other party, but inasmuch as the paper was one of the leaves of a paper book encased within a leather cover upon which the plaintiff's name was stamped, it was held that the name on the cover could be treated as a part of the memorandum.[2]

When the substance of the agreement can be ascertained only from several separate and distinct documents, all signed documents which show on their face that they relate to the same transaction may be read together even though no one of the writings expressly refers to any of the others. If, however, some of the documents are signed and others unsigned a more troublesome situation is presented. The correct rule in such a case would seem to be that a signed document may have its inadequacies cured by another document only if it refers in express terms to the other, and that an incomplete unsigned document gains nothing from the contents of any other document even by an express reference to that document. No other result is possible if there is to be a firm adherence to the rule that the signature of the party to be charged shall authenticate all of the written evidence which is needed to set forth the substance of the transaction. It must be said, however, that some courts have shown a disposition to overthrow this requirement. The following is a typical case of this kind:

§127 *LERNED v. WANNEMACHER.*

Supreme Judicial Court of Massachusetts, 1864.
[9 *Allen* (*Mass.*) 412.]

[Plaintiffs made an oral contract to buy 1,000 tons of coal of the defendants and then signed and delivered to the defendants a memorandum of the contract. At the same time the defendants signed and delivered to the plaintiffs a duplicate memorandum which differed, however, from the other memorandum in failing to disclose the name of the plaintiffs. It was held that there was a sufficient connection between the two documents to satisfy the statute.] HOAR, J., said of the two papers: "The two show clearly . . . which party was the seller, and which the

[1] *Pearce v. Gardner* (1897), I Q. B. 688.
[2] *Jones Bros. v. Joyner* (1900), 82 L. T. (N. S.) 768.

purchaser. And we can see no reason upon principle or authority why they should not have the same effect, as if both the signatures were to the same paper.''

§128. *Part Payment or Acceptance and Actual Receipt of Goods Under the Seventeenth Section of the Statute of Frauds.* —The 17th section of the statute may also be satisfied either by part payment or by acceptance and actual receipt of part of the goods sold. Only a signed memorandum will suffice to satisfy the 4th section of the Statute of Frauds, but the 17th section does not insist upon written evidence of the transaction whenever there has been either part payment or an acceptance and actual receipt of part of the goods sold. Any one of the three methods of satifying the 17th section may be used in connection with any transaction to which this section is applicable, whether it be an actual sale of goods or an executory contract to sell goods. As a matter of fact, however, a satisfaction either by means of part payment or by means of acceptance and actual receipt of part of the goods sold is much more common when there is a present sale of goods than when there is merely a contract to sell goods.

The original Statute enacted that a sale or a contract to sell goods would be enforceable if a buyer gave ''something in earnest to bind the bargain or in part payment.'' Although these words have been widely copied by the American legislation on the subject, the word ''earnest'' is understood in this country to be synonymous with part payment.

Part payment may be made subsequent to the oral agreement, unless, as in a few states, the statutory provision expressly requires that it be made ''at the time of the contract.''

The question of the greatest difficulty with respect to part payment is the effect which should be given to an agreement by a seller who is indebted to the buyer on a previous account, that the amount of this indebtedness shall be taken as part payment. Some courts have laid it down that a mere agreement of this kind cannot operate as part payment to satisfy the requirements of the Statute. Other courts, however, have regarded such a ruling as more stringent than the words of the Statute demand, and

have therefore held that an absolute extinguishment by agreement of the previous debt of the seller is equivalent to a part payment by the buyer. The latter doctrine seems to be the preferable one. If, however, the agreement contemplates only a future extinguishment of the pre-existing debt it would nowhere be regarded as a part payment.[1]

Another way of validating an oral transaction which is within the 17th section of the Statute is for the buyer to "accept part of the goods so sold and actually receive the same." This clause describes two requisites, both of which must be present in order adequately to fortify the transaction. As a matter of business, a receipt of the goods usually precedes acceptance of them, but the Statute does not prescribe the order of these acts.

The word "acceptance" has received a highly artificial interpretation by the English courts. In this country, however, the construction commonly given to this word is in accord with its natural meaning, and it is generally held that no acceptance takes place unless "the buyer, either before or after delivery of the goods, expresses by words or conduct his assent to becoming the owner of those specific goods."[2]

"Actual receipt" means the acquisition of possession of the goods by the purchaser. While, of course, the physical delivery of the goods by the seller to the buyer constitutes an "actual receipt," a transfer of the possession of the goods may also be effected in other ways. For example, it is held that there is an actual receipt of the goods whenever the seller under the direction of the buyer parts with the possession of the goods and delivers them at a designated warehouse where the buyer is accustomed to keep his goods.[3] "Actual receipt" of the goods may take place even when the change of possession is not actual, but is merely constructive, as the lawyers phrase it. This is generally held to be possible, for instance, even though the goods remain in the possession of the seller. Under these circumstances, however, the evidence must be clear and convincing that the seller has consented to divest himself of his lien upon the

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[1]See *Walker v. Nussey* (1847), 16 M. & W. 302.
[2]This language is taken from the Uniform Sales Act, §4, (3).
[3]*Cusack v. Robinson* (1861), 1 B. & S. 299.

goods for the purchase price and holds them wholly as bailee for the buyer.[4]

§129. *The Effect of the Statute.*—The statute apparently establishes a rule of remedial procedure. Non-compliance with either section 4 or section 17 of the Statute is held in England to affect only the enforceability, not the validity of the agreement. As regards the American states, there is no universal uniformity in the wording of the Statute, some of the statutes declaring a contract to be "void" whenever there is a failure to comply with the statutory requirements. In most of the American jurisdictions the judicial interpretation of this part of the local statute is the same which has been given to the classic English statute by English judges. In a few states, however, the Statute is interpreted as making an agreement utterly void if the statutory requirements are not satisfied.

The precise effect of the Statute in the former class of jurisdictions is a matter which is still somewhat uncertain. It would seem upon the whole, however, that the Statute is more than a mere rule of evidence. If a defendant does not affirmatively plead the Statute, and many business men would scorn to set up a defense so technical, oral evidence of the transaction is admitted in the majority of jurisdictions. Moreover, according to the weight of authority a memorandum obtained by the plaintiff after the commencement of his action will not satisfy the Statute, though one obtained after the making of the contract, but before the commencement of the action, will. It therefore seems preferable to hold that the Statute has to do with certain prerequisites to the bringing of an action rather than with certain methods of proof. In other words, the Statute operates as a rule of procedure, and in this respect is analogous to a statute of limitations which prohibits the plaintiff from enforcing a right of action unless he begins suit within a certain number of years.

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[4]In three or four states, including New York, it has been held that mere words, however significant, can never satisfy the statutory requirement of an actual receipt of the goods, and that nothing short of some unequivocal act with reference to the goods will be recognized as sufficient.

In certain situations a plaintiff is entitled to relief on equitable principles, although barred by the statute from suing on the agreement. Generally speaking a court of equity considers itself bound by the Statute as fully as a court of law. Mere refusal by the defendant to live up to his oral agreement, however reprehensible his conduct may be, has never been supposed to afford a ground for interference by equity. Even a premeditated omission by him to execute a signed writing in order that he might be in a position to repudiate his promise, is not held to give the plaintiff a right to enforce the promise.

If, however, a defendant, after binding himself by a sufficient memorandum of the agreement, commits an actual fraud in order to induce the plaintiff to surrender the possession of the document, a court of equity will decree specific performance of the agreement as originally made.[1] In a case of this kind it is unquestionably proper for equity, as an exercise of its well-recognized power of relieving against fraud, to enforce specific reparation for the tort.

Most courts of equity go further, and hold that "part performance" may also remove the bar of the Statute. According to this anomalous doctrine, the Statute affords no defense to a bill for specific performance of an oral agreement for the sale or lease of real estate whenever there has been "part performance" of the agreement.[2] That the doctrine is anomalous is confirmed by the pronounced disagreement in the decisions over what constitutes a part performance sufficient to liberate such an agreement from the operation of the Statute. In many jurisdictions nothing more is required than merely taking possession of the land with the acquiescence of the seller or lessor. Where this rule prevails, it is made to rest upon the theory that equity should enforce an oral agreement whenever there has been some unequivocal act referable only to the subject-matter of the dispute. At bottom this explanation rests upon the unwarranted assumption that equity is justified in accepting a substitute for

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[1]For a picturesque report of such a case, see *Mullet v. Halfpenny* (1699), Prec. Ch. 404; Ames's Cases in Equity Jurisdiction, p. 315.

[2]The doctrine of "part performance" is repudiated in only four states: Kentucky, Mississippi, North Carolina, and Tennessee.

the writing required by the Statute whenever other evidence sufficiently indicates the existence of an agreement. Moreover, under this explanation there is no apparent reason why the doctrine of "part performance" should be restricted to cases involving land, although in fact most courts do so restrict the doctrine. The truth is that it is impossible to find a sound basis for giving equity jurisdiction to decree specific performance of oral agreements within the statute, except when the defendant is being charged "upon the equities resulting from the acts done in execution of the contract and not upon the contract itself."[3] According to this view, it is proper to give a plaintiff specific performance of an oral agreement only when he has irretrievably changed his position in reliance on the agreement, or in other words, when he would suffer irreparable injury if the other party should be permitted to avoid the agreement. It must be admitted, however, that this view is actually followed only in Massachusetts, Texas, and perhaps a few other states.

Frequently a plaintiff who is not entitled to a decree for specific performance under the doctrine of "part performance" may enforce restitution against a defendant who has received a benefit under the unenforceable contract. The basis of the cause of action in such cases is the duty which the law imposes upon the defendant to make restitution to the extent of his unjust enrichment.[4]

PRACTICE PROBLEMS

(a) A offered B a position at $150 a month for one year beginning on Monday of the following week, and told B to think it over and if he wanted the position to report for work on the following Monday. B made no promise to accept the position but appeared on the following Monday and was put to work by A. Three days later A discharged him without cause. B sues for breach of contract. A in his defense

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[3]*Maddison v. Alderson* (1883), 8 A. C. 467, per Selbourne L. C.

[4]The true nature of the obligation sued upon in these cases is well brought out in the case of *Day v. N. Y. Central R. R. Co.* (1873), 51 N. Y. 583. For an able treatment of the whole subject, see Woodward, *The Law of Quasi Contracts*, ch. VI.

For a long time the only court which as a rule concerned itself with the moral duty to make restitution was Chancery, but in modern times common-law actions are available for compelling restitution in value.

denies that there was a contract and also sets up the Statute of Frauds. Judgment for whom?

(b) A sold out his grocery to B and orally promised him, as part of the consideration of the sale, not to engage in the same business in the same town for a period of five years. Within a year A broke his promise. B sued for breach of contract. A in his defense set up the Statute of Frauds. Judgment for whom?

(c) A contract for employment for more than one year was signed only by the employer. The employer, desiring to be relieved from the agreement, wishes to know from you whether the requirements of the Statute of Frauds have been satisfied.

(d) A made an oral contract with B whereby he agreed to sell to B one hundred shares of stock of a certain corporation for $15,000. As soon as the bargain was made, A said, "I suppose we have to make a memorandum of our transaction. Won't you make it and sign both our names to it?" B did as requested, in A's presence and with his entire approval. Can B hold A?

D. Special Rules Applicable to Agreements in Writing.

§130 *GLACKIN v. BENNETT.*

Supreme Judicial Court of Massachusetts, 1917. [226 *Mass.* 316.]

[This is a suit to recover purchase price paid for an automobile for alleged breach of warranty. In the Superior Court before Hall, J., jury found for plaintiff and defendant excepted.]

CARROLL, J.: In October, 1912, the plaintiff bought from the defendants a second-hand, 1907 Peerless motor car, for which he paid $600. At this time a written agreement was executed, a copy of which is printed [in a footnote[1]]. This action

[1] "W. H. Bennett, H. M. Doane, J. R. Honors.

ESSEX AUTOMOBILE COMPANY
Pleasure and Commercial Vehicles

Telephones: 172-173-8273 170 Broad Street
Lynn, Massachusetts, 9/30/12

Sold to Frank J. Glackin, 73 Harwood St., Lynn, Mass.

1 Used 1907 Peerless car	$600.00
Credit by deposit October 1, 1912	50.00
Balance	$550.00

Guarantee as to parts same as with new car.

Essex Auto Co.
H. M. Doane.

Received payment,
October 7, 1912,
ESSEX AUTOMOBILE COMPANY,
Per "

is to recover for the breach of an oral warranty (made during the negotiations resulting in the sale) that the motor car could be operated twelve miles on one gallon of gasoline. There was no evidence of fraud nor of a breach of any of the terms of the written contract. On the cross-examination of the plaintiff, when the written contract for the first time appeared in evidence, he testified that when it was delivered he inquired concerning the warranty; thereupon the defendant Doane wrote what appears on the agreement in pencil, namely: "Guarantee as to parts same as with a new car." "I asked him to give me the guarantee that went with a new car. If that is the guarantee that goes with a new car I got all I asked for." He also testified that he did not know what Doane wrote. In the superior court the verdict was for the plaintiff.

When it is apparent that the writing contains only a part of the agreement and does not purport to set forth all its terms, or when it is a reasonable inference that it was not intended to be a full and final statement of the entire transaction, the existence of a separate agreement, not inconsistent with its terms and relating to some subject on which the written instrument is silent, may be shown by parol. *North Packing & Provision Co. v. Lynch,* 196 Mass. 204, 206. *Green v. Danahy,* 223 Mass. 1, 4. See also *West End Mfg. Co. v. Warren Co.,* 198 Mass. 320; *Davis v. Cress,* 214 Mass. 379; *Brooks Co. v. Wilson,* 218 Mass. 205. But where a writing shows on its face that it includes the whole agreement of the parties and comprises all that is necessary to constitute a contract, it is presumed that they have placed the terms of their bargain in this form to prevent misunderstanding and dispute, intending it to be a complete and final statement of the whole transaction. And all their stipulations relating to its subject-matter are to be found within the written instrument.

"The rule forbidding the introduction of parol testimony to vary or contradict a written agreement is not merely one of evidence, though commonly, perhaps, so spoken of, but one of substantive law, and rests on the doctrine that when parties have deliberately put their agreements in the form of a written contract they shall not be allowed to show that the agreement was something else." *Mears v. Smith,* 199 Mass. 319. *Butterick Publ. Co. v. Fisher,* 203 Mass. 122. *Fairfield v. Lowry,* 207 Mass. 352, 358. *Rochester Tumbler Works v. M. Woodbury Co.,* 215 Mass. 194, 197. *Goldenberg v. Taglino,* 218 Mass. 357, 359. By deciding to put in writing all their promises they made the writing the sole record of their agreement; they agreed to this by the execution of the contract. Its terms and conditions therefore must be sought in the instrument wherein they are re-

corded, to modify; enlarge or contradict them, would violate the substantive rights of the parties. The instrument was complete in itself—it showed on its face that it denoted a complete legal obligation and contained all the conditions of the contract; it gave the name of the buyer and of the seller, the make and kind of automobile, the price paid, the acknowledgment of payment, and the specific warranty "as to parts same as with a new car." In view of this it is unnecessary to consider the testimony of the plaintiff, and what inferences, if any, were to be drawn from it, showing his acceptance of the writing as a final and complete account of the agreement.

Although the plaintiff testified he did not know what Doane wrote when the addition in pencil was made, there was no fraud practiced upon him. He accepted the instrument as a final statement definitely fixing the terms of the agreement; and even if he did not sign it, no question under the statute of frauds arising, he is bound by it. See *Old Colony R. R. Corp. v. Evans,* 6 Gray, 25, 32, and cases cited.

There are no obscure words in the document requiring explanation, and oral evidence cannot be resorted to for this purpose. *Waldstein v. Dooskin,* 220 Mass. 232, 235.

An express warranty, which is an affirmation of fact inducing the sale (sales act, St. 1908, c. 237, s. 12) cannot be added to the written agreement, under the rule permitting an agreement by parol, which is collateral to the contract and on a distinct subject, to be proved. *Durkin v. Cobleigh,* 156 Mass. 108. *Keith v. Radway,* 221 Mass. 515, 517, and cases there collected. *Dawson v. Grote,* 222 Mass. 240. If the terms of the sale are in writing, extrinsic evidence of an express warranty not referred to in writing, is not admissible, subject of course, to the exception that the document is not a mere bill of parcels or other imperfect and incomplete record of the agreement. *Whitmore v. South Boston Iron Co.,* 2 Allen 52, 58. *Neale v. American Elec. Vehicle Co.,* 186 Mass. 303, and cases cited. *Frost v. Blanchard,* 97 Mass. 155. *School v. Killoran,* 190 Mass. 493. *Leavitt v. Fiberloid Co.,* 196 Mass. 440, 445. It is also to be mentioned that the contract was not silent on the question of warranting the motor car. When some particular subject is dealt with in the writing, it is presumed that the complete engagement on that subject is contained in the written contract. When the plaintiff asked for a warranty one was inserted. "By requiring a warranty, he is to be understood as excepting against all terms but such as are stipulated in the bargain." *Yeats v. Pim,* Holt 95. *Webb v. Plummer,* 2 B. & Ald. 746, 750. The contract expressly provided that "Guarantee as to parts same as with a

new car'' and an additional warranty guaranteeing the extent of the consumption of gasoline in its operation, could not be added by parol. The defendants' request that the oral statements of warranty introduced before the written agreement was in evidence, be stricken out, should have been granted.

As there was no breach of the written agreement and it could not be changed by parol, it is unnecessary to consider the other questions raised by the defendant.

Exceptions sustained.

Judgment for the defendant.

§131 *VIOLETTE v. RICE.*

Supreme Judicial Court of Massachusetts, 1899. [173 *Mass.* 82.]

Bill in equity, filed November 20, 1896, in the Superior Court, against Charles E. Rice and Edward E. Rice, co-partners as C. E. and E. E. Rice, and others not material to be named, to reach and apply property in payment of damages for an alleged breach of a contract of employment. Hearing before Sheldon, J., who ordered a decree to be entered dismissing the bill; and, the plaintiff having appealed, reported the case, at the request of the parties, for the determination of this court. The facts appear in the opinion.

HOLMES, J.: This is a bill in equity to reach and apply property which is alleged to have been conveyed in fraud of the plaintiff, claiming damages for a breach of contract to employ the plaintiff in the part of Bertha Gessler in a play called ''Excelsior Junior.'' The contract was in writing, and engaged the plaintiff in general terms ''to render services at any theatres,'' etc., the plaintiff agreeing ''to conform to and abide by all the rules and regulations adopted by said Edward E. Rice for the government of said companies.'' On the back of the contract, which seems to have been put in by the plaintiff, were ''Rules of the Rice Burlesque Companies,'' one of which was, ''No person shall . . . refuse a part allotted to him or her by the manager'' on certain penalties, including discharge at the option of the manager. These rules were not set out in the copy of the contract annexed to the bill and admitted by the answer, but no objection seems to have been made on this ground, and, if any objection had been made, of course an amendment to the answer would have been allowed. At the hearing, evidence was taken *de bene* that at the time of signing the contract it was agreed that the general word ''services'' meant services in the particular part named. This evidence ultimately was rejected, and the only question is whether it should have been admitted.

We are of opinion that the evidence could not be received. The plaintiff accepted the defendants' rules by signing the contract, whether she knew them or not. It is not a question here whether an indorsement upon a contract, not referred to upon the face of the instrument, is part of the contract by virtue of the indorsement alone. The plaintiff expressly adopted any rules which there might be, within the reasonable import of the name, even though not set out in the contract, and if she adopted them in the dark she was bound none the less. See *Lehigh Valley Railroad v. Snyder,* 72 Vroom, 326.

With or without rules, the engagement to render services expressed a general employment, which could not be limited to a single part without contradiction. For to give evidence requiring words to receive an abnormal meaning is to contradict. It is settled that the normal meaning of language in a written instrument no more can be changed by construction than it can be contradicted directly by an avowedly inconsistent agreement, on the strength of the talk of the parties at the time when the instrument was signed. *Black v. Bachelder,* 120 Mass. 171; *Flynn v. Bourneuf,* 143 Mass. 277, 278; *Chemical Electric Light & Power Co. v. Howard,* 150 Mass. 495; *Goode v. Riley,* 153 Mass. 585, 586; *Poole v. Massachusetts Mohair Plush Co.* 171 Mass. 49, 52; *Grimston v. Cunningham,* [1894] 1 Q. B. 125. When evidence of circumstances or local or class usage is admitted, it tends to show the ordinary meaning of the language in the mouth of a normal speaker situated as the party using the language was situated, "but to admit evidence to show the sense in which words were used by particular individuals is contrary to sound principle." *Drummond v. Attorney-General,* 2 H. L. Cas. 837, 863. "If that sort of evidence were admitted, every written document would be at the mercy of witnesses that might be called to swear anything." *Nichol v. Godts,* 10 Exch. 191, 194. To similar effects, Shaw, C. J., in *Brown v. Brown,* 8 Met. 573, 577; *Tymason v. Bates,* 14 Wend. 671, 675. The case of *Keller v. Webb,* 125 Mass. 88, goes a good way, but was not intended, we think, to qualify the principle settled by the earlier and later Massachusetts cases, some of which we have cited. In that case evidence of conversation was admitted to show that "casks" in a written contract meant casks of a certain weight. It was assumed that the contract meant casks of some certain weight, but did not state what, and thus that the evidence supplemented without altering the written words. A similar explanation applies to *Stoops v. Smith,* 100 Mass. 63. The other cases cited do not need particular notice.

Decree affirmed.

§132. *Special Rules Applicable to Agreements in Writing.*—With respect to most classes of agreements, the form of expressing agreement rests within the uncontrolled discretion of the parties. As a matter of fact, however, an agreement definitely embodied in a writing has such obvious advantages that it is the prevailing form of agreement in certain businesses. Insurance contracts, contracts for construction, and ordinary building contracts are nearly always in writing, although in most states not required by law to be in writing (except when the contract is not to be performed within a year). The process of reducing an agreement to writing promotes definiteness and thus minimizes the possibilities for an honest or dishonest dispute as to the terms agreed upon. Prudence demands that all terms be in black and white whenever an agreement relates to a matter of any importance, especially if its provisions are at all complicated. As regards certain agreements, various statutes, notably the Statute of Frauds, require written evidence in order to make the agreement enforceable. True enough, a mere memorandum of the transaction, if signed, will comply with all the requirements of the average statute. Nevertheless, the additional inconvenience of drawing up a writing which purports to constitute the complete and final statement of the agreement is not very great, and the practice of reducing agreements to writing has undoubtedly been fostered by these statutory requirements as to form.

Let us consider some of the more important rules that are applicable whenever the parties have, for any reason, incorporated their agreement in a writing which is intended to stand as and for their agreement.

§133. *The Incontestability of the Terms of Written Agreements.*—If a writing purports to contain the whole agreement, its terms cannot be contradicted or added to by evidence extrinsic to the writing. When a valid agreement has been reduced into a writing purporting to contain the whole agreement, "parol evidence" of what took place either prior to, or contemporaneous with the reduction of the agreement into writing, is inadmissible for the purpose of contradicting, varying, adding

to, or subtracting from the terms of the written agreement.[1] The rule by which all preceding and contemporaneous oral expressions of the parties are merged in the writing and displaced by it so that the writing becomes the exclusive memorial of the transaction is referred to as "the parol evidence rule." In this so-called "parol evidence rule," which exists for the protection of the efficacy of writings,[2] there are also comprehended the rules relating to the admission of extrinsic evidence in aid of interpretation of writings. The term "parol evidence rule" is really a misnomer, since neither that aspect of the rule which relates to the conclusiveness of the documentary evidence nor, with a single exception, that aspect which relates to the use of extrinsic evidence in aid of interpretation, is concerned with the evidential quality of facts extraneous to the writing. The doctrines are really rules of substantive law pertaining to writings. "What the rule does is to declare that certain kinds of facts are legally ineffective in the substantive law; and this, of course (like any other ruling of substantive law), results in forbidding the fact to be proved at all."[3]

Why, after an agreement has been reduced into writing, is the document made the conclusive expression of the agreement? Leaving out of account the sources and historical development of the rule, it may be urged in vindication of the rule that in the great majority of cases it effectuates an intention of the parties to secure protection from what Lord Coke called "the uncertain testimony of slippery memory." Many practical men who have had experience with persons who attempt to repudiate their bargains are by no means displeased that there is a doctrine which protects at least one form of agreement from being "at the mercy of witnesses that might be called to swear anything."[4] On the other hand, however, it is of course true that many laymen are unaware of the existence of the rule and often give their

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[1] By "parol evidence" is meant all evidence which is extrinsic to the document in question.

[2] The rule applies not only to written agreements, but also to all writings which evidence the creation, transfer, or extinguishment of legal rights, such as a deed of conveyance, release under seal, and the like.

[3] Wigmore, *Evid.*, §2400.

[4] *Nichol v. Godts* (1854), 10 Ex. 191, 194, per Pollock, C. B.

assent and signature to a document which does not entirely conform to the real understanding of the parties. Whatever view be taken of the policy underlying the legal rule, the practical point for laymen to remember is that every agreement in writing, including hereunder the printed form with the small-type provisions, is anything but a mere "matter of form," and that grave risks are run if a writing purporting to embody the entire agreement is either an inaccurate, incomplete, or inadequate expression of the agreement.

The limits of the parol evidence rule are fixed by the underlying reason for it. The rule "only applies where the parties to an agreement reduce it to writing, and agree or intend that the writing shall be their agreement."[5] In applying the principle thus expressed it has become settled that certain kinds of informal business documents fall outside the scope of the rule. For instance, although a receipt may be so drawn as to constitute a contract, it does not commonly operate to create legal relations, and hence a receipt may be either contradicted or supplemented by oral testimony or other extrinsic evidence. In *Allen v. Pink,* 4 M. & W. 140 (1838), the following memorandum was given to the buyer of a horse: "Bought of G. Pink, a horse for the sum of £7 2s. 6d. G. Pink." It was held that this paper did not preclude Allen from proving that Pink had orally warranted the horse quiet in harness.

§134. *Integration of Separate Writings Embodying a Contract.*—If a writing appears to embody an agreement but shows on its face that it was not intended to express the whole agreement, the situation calls for a different treatment. While it is held that such a writing has not integrated all prior and contemporaneous oral agreements, and hence that proof may be given not merely of any term obviously omitted but also of a prior or contemporaneous collateral agreement as to any matter on which the writing is silent, such proof may be given only in order to supplement the writing, never to contradict it.[1] May

[5]*Harris v. Rickett* (1859), 4 H. & N. 1, 7, per Pollock, C. B.

[1]Even in the case of a deed or a written contract the recital of consideration is like the date of the instrument, not regarded as one of the matters of agreement, and hence may be contradicted, and not merely supplied when omitted.

parol evidence of such collateral agreement be admitted when the incompleteness of the agreement in writing can be made to appear only by going outside of the writing? This is a question on which divergent opinions have been expressed by the courts. It would seem that the soundest view is one lying between both extremes, and such a rule has been formulated by an able judge, as follows: "The true rule is that the only criterion of the completeness of the written contract as a full expression of the agreement of the parties is the writing itself; but, in determining whether it is thus complete, it is to be construed, as in any other case, according to its subject-matter and the circumstances under which and the purposes for which it was executed."[2]

Evidence of established local or class usage is admissible in order to ingraft into an oral agreement such customary incidents as are not expressly or impliedly excluded by the terms of the agreement, and the same rule applies to written agreements. The admission of such evidence to supplement the terms expressed in writing is justified on the ground that since the customary terms are an accustomed part of the class of agreement in question, it should be assumed that the parties did not mean to express in writing the whole of the contract by which they intended to be bound, but to contract with reference to those known usages. In other words, the writing is regarded as merely an incomplete statement of the agreement except, of course, when the usage is expressly or impliedly excluded by the tenor of the instrument.

§135. *Invalidation of Written Agreements.*—It has been said that "the right to prove fraud, in whatever shape it may exist, to avoid written contracts, has been so uniformly recognized that it can hardly be said to have been the subject of serious judicial discussion."[1] Similarly, duress, illegality of subject-matter, legal incapacity of one of the parties, want or failure of consideration, and mistake, may be proved by extrinsic evidence to impeach the validity of the written agreement. Moreover, it can

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[2] *Wheaton, etc., Co. v. Noye Mfg. Co.* (1896), 66 Minn. 156, 160, per Mitchell, J.

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[1] *Cummings v. Cass* (1889), 52 N. J. L. 77, 82, per Reed, J.

always be shown by oral evidence that a written agreement was executed subject to a condition that was never fulfilled; for instance, oral evidence will be admitted to prove an oral agreement that a written contract was not to become operative until a favorable report on the financial condition of one of the parties should be received from a commercial agency.[2] In all of these cases it is plain that the admission of extrinsic evidence does not really violate the parol evidence rule, for the effect of the evidence is not to contradict the writing, but merely to show that no enforceable rights were acquired under it.[3]

§136. *Oral Rescission or Modification of Written Contracts.* —A contract in writing may be rescinded before breach by word of mouth, and, unless the Statute of Frauds is applicable, may also be varied by word of mouth. In the case of an agreement which is not within the Statute of Frauds, but which, nevertheless, is in writing, "it is competent to the parties at any time before breach of it, by a new contract not in writing, either altogether to waive, dissolve, or annul the former agreement, or in any manner to add to, or subtract from, or vary, or qualify the terms of it, and thus to make a new contract, which is to be proved, partly by the written agreement and partly by the subsequent verbal terms engrafted upon what will be thus left of the written agreement."[1] The explanation of this is simple. However much a written agreement may indicate the finality of the writing with regard to the terms of a bargain at the time it was made, no reason exists for depriving the parties of their discretion with respect to the form which any of their future contracts shall take, even though the future contract be one which changes or does away altogether with a prior written agreement. Hence discharge of a written contract may be estab-

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[2]*Reynolds v. Robinson* (1888), 110 N. Y. 654.

[3]To this generalization there is one exception. If, because of a mistake common to both parties, a written agreement fails to express the true agreement, a court of equity (if evidence of mutual mistake is clear, unequivocal, and decisive), will decree that the writing be altered and be made to conform to the actual agreement. Except when a suit is brought for reformation of an instrument, the operation of the parol evidence rule is the same in equity as at law.

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[1]*Goss v. Lord Nugent* (1883), 5 B. & Ad. 58, 64.

lished by oral testimony, not only when discharge of the obligation is by performance of the contract, or by an accord and satisfaction, but also when the discharge is by mutual rescission or novation. For the same reason, oral changes by mutual consent are always possible, notwithstanding even an expressed stipulation in the written agreement that no changes unless agreed on in writing are to be effective.

With respect to an agreement within the Statute of Frauds, however, a distinction must be observed. Contracts of rescission do not fall within the terms of the Statute of Frauds, and it is therefore always possible, if the contract is otherwise enforceable, orally to effect an absolute and outright rescission of the original written agreement.[2] It is a very different case, however, when the subsequent oral agreement is one which purports merely to vary some of the terms of the original agreement. The alteration is intended as the substitution of a new agreement. Since, however, the new agreement relates to a subject-matter to which the Statute of Frauds is applicable, the fact that it is only partly in writing and partly oral renders it unenforceable.[3] From this it follows that the original agreement remains in full force notwithstanding the parties' intention to the contrary.

Executed transactions, it will be remembered, are unaffected by the Statute of Frauds. If, therefore, there has been a full performance of an oral agreement which purports to vary a preexisting written agreement the same legal consequences exist that would follow upon the performance of an enforceable contract, namely, the substituted performance has operated as an "accord and satisfaction" of the original agreement, thereby

[2]In some, but not in all jurisdictions, an exception is made when the original contract was one for the sale of land. It is argued, and with good reason, that the right of specific performance of such a contract gives the purchaser "an interest in" the land from the moment of the contract, and that a rescission, being tantamount to a reconveyance of this interest, is within the Statute.

[3]It is held in Massachusetts, however, that a subsequent oral agreement for a substituted performance is unaffected by the Statute of Frauds on the ground that the Statute does not undertake to regulate the performance of agreements. *Cummings v. Arnold* (1842), 3 Met. 486. This view, which seems also to have been adopted in Maine and Mississippi, is opposed by the decided weight of authority.

discharging all rights and liabilities under the original agreement.

§137. *Construction of Written Agreements.*—According to the modern view, extrinsic evidence is admissible to affect the interpretation of a written agreement. Words, whether spoken or written, are but symbols; "in any case, the words used must be translated into things and facts by parol evidence."[1] The process of interpreting a written agreement, therefore, inherently requires at least a certain amount of inquiry into external facts. Resort to extrinsic evidence is necessary in order to enable the court to identify the persons and things to which an instrument refers or to clear up any doubt that may arise in applying the instrument to the facts. But should no limits be set to the admission of extrinsic evidence as an aid in the interpretation of a document?

Opposing views as to the object of interpretation have struggled for supremacy, and differences of opinion on this subject have been partly responsible for the diversity of authority which unfortunately still exists with respect to the precise extent to which extrinsic evidence should be employed in aid of interpretation. One school regards determination of the actual intention of the writer as the object of interpretation. This view is not one which is commonly accepted, certainly so far as the interpretation of agreements is concerned. But what external standard should be adopted? Should courts seek for the popular, common meaning of words as used by the community, or, secondly, should they seek for the meaning which the party using the words should reasonably have expected would be attached to them by the other party, or, thirdly, should they seek for the meaning which under the existing circumstances would be attached to the words by persons of the kind and class of those who were parties to the agreement? Frequently, of course, the result will be the same whichever of these external standards of interpretation should be applied; nevertheless, there are cases in which a choice of these possible standards is attended with practical consequences. If mutual assent as to terms be expressed

[1]*Doherty v. Hill* (1887), 144 Mass. 465, 468, per Holmes, J.

only by word of mouth or by written memoranda or correspondence which was not adopted by the parties as a memorial of their agreement, the second of the above-enumerated external standards is the one which has been meeting with increasing acceptance.[2] If, however, the agreement is embodied in a writing intended to stand as and for the agreement, the weight of authority inclines toward the third standard,—the "local" standard.[3] It is not difficult, however, to find numerous judicial utterances favorable to the first described standard,—the "normal," or "popular," standard. In the case of informal agreements there would seem to be no objection to permitting the parties, by private convention, to attach a special meaning peculiar to themselves to their words. On the other hand, as regards any writing which has been agreed upon by the parties as a memorial of their agreement there seems to be little judicial dissent from the view expressed in the case set out above, that "to give evidence requiring words to receive an abnormal meaning is to contradict."[4] It is, of course, entirely consistent with this position to admit evidence of the surrounding circumstances in which the words were used so far as such evidence tends to make clear the "local" meaning of the language used. As the same authority has said more recently in a different connection: "A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly according to the circumstances and the time in which it is used."[5] On the other hand, courts with a predeliction for the "normal" standard, rigidly exclude extrinsic evidence whenever the words of a written agreement have a plain, ordinary, and popular meaning and are unambiguous in their ordinary meaning.[6] Even these courts, however, tend to make exceptions, especially so when it is shown that the parties made their agreement with reference to an established local usage or a "custom of trade." In such a case the meaning of the language employed will be determined, according to the

[2]Williston on *Contracts*, §605.

[3]*Ib.*, §§606-608.

[4]*Violette v. Rice* (1889), 173 Mass. 82, 84, per Holmes, J.

[5]*Towne v. Eisner* (1918), 245, U. S. 418, 425, per Holmes, J.

[6]For a recent statement to this effect, see *Cawley v. Jean* (1914), 218 Mass. 263, 268.

prevailing tendency, by evidence of the local usage or the peculiar meaning of the term in the "mercantile dictionary."

The various rules and principles governing the admission of extrinsic evidence in aid of interpretation have been reduced to seven propositions in a famous treatise of Sir James Wigram on *Extrinsic Evidence in Aid of the Interpretation of Wills,* published in 1831. The phraseology of these propositions relates to wills, but the propositions are, on the whole, equally applicable to documents *inter vivos.* A full statement and elucidation of the propositions is impossible within the scope of this work. The second, relating to "primary meanings," deals with the problem adverted to in the preceding paragraph. The doctrine of this proposition still survives in many jurisdictions, despite the vigorous assaults to which it has been subjected from time to time. Because of its importance to those who may draft business documents, a carefully phrased statement of the doctrine may be useful. Perhaps as good a statement of it as any is the one to be found in a Connecticut case: "Where language is used in any written instrument which in its primary meaning is unambiguous, and in which that meaning is not excluded by the context, and it is sensible with reference to the extrinsic circumstances in which the parties to the instrument were placed at the time the writing was made, such primary meaning must be taken conclusively to be that in which the parties used it; such meaning in that case conclusively states the intention of the parties, and no evidence is receivable to show that in fact the parties used the language in any other sense, or had any other intention."[7]

Another rule of exclusion which had its origin in the days when judges were inclined, so far as possible, to interpret documents by what was found "within the four corners of the paper," is now happily in a process of gradual dissolution. According to one of Lord Bacon's maxims, while a "latent" ambiguity (by which is meant one which arises merely extrinsically from the application of the instrument to its subject-matter) would justify a resort to extrinsic evidence, outside data

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[7] *Hildreth v. Hartford, etc., Tramway Co.* (1901), 73 Conn. 631, 636.

could not be used to explain a "patent" ambiguity, that is, one which is apparent on the face of the instrument. This distinction, according to the more enlightened modern view, is both unprofitable and confusing. "The true rule with regard to patent ambiguities must be taken to be this: The patent ambiguity which cannot be explained by parol evidence is that which remains uncertain after the court has received evidence of the surrounding circumstances and collateral facts which are of such a nature as to throw light upon the intention of the parties."[8]

Even when the situation permits the introduction of extrinsic evidence in aid of interpretation, there is one kind of revelant matter which cannot be taken into account, namely, direct extrinsic declarations of the writer's intention. This is deemed too dangerous to permit of its admission.[9] Even this single excluding rule is inoperative in one situation. Direct extrinsic expressions of the writer's intention may be given in evidence in the case of an equivocation, that is to say, where the description of a person or thing is found, upon its being applied to external objects, to be equally applicable to more than one.

The prevailing practice in the interpretation of written agreements is to make a more liberal use of extrinsic evidence than was permitted in earlier times. Always, of course, the words actually used must be capable of bearing the sense sought to be put upon them, or otherwise the process is not one of genuine interpretation whenever the law makes the writing the sole memorial of a transaction. To permit a meaning unexpressed in such a writing to be imported into it would not be interpretation but the creation of an agreement for the parties. The sufficiency of a written expression in any concrete case is a question about which differences of opinion may often be reasonably entertained, for it is entirely a question of degree. In order to determine the limits of interpretation in any particular case, a court familiarizes itself with past decisions no less care-

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[8] 17 Cyc. 682.

[9] Of all the rules generally included in discussions of the parol evidence rule, this seems to be the only rule that is not a rule of substantive law but one of evidence.

fully than when passing upon a rule of law. The usefulness of such a study of the authorities has been expressed by a thoughtful writer as follows: "By the combined result of the decisions of a succession of judges, each bringing his mind to bear on the view of those who preceded him, a system of interpretation is built up, which is likely to secure a much nearer approach to perfect justice than if each interpreter were left to set up his own standard of how far it was right to go in supplying the defective expression."[10]

§138. *Language Used Improperly.*—Certain kinds of contracts are commonly drafted in set forms; for example, negotiable instruments, bills of lading, insurance policies, and, more recently, building contracts. One of the advantages of a standard form of agreement is the fact that judicial precedents have established a uniform construction which will be given to many of the words and phrases. Another advantage of a contract drawn in a set form is the careful precision of the language used. In unstandardized agreements carlessness, ignorance, or haste is apt to give rise to obscurities or contradictions in the language which is employed.

In the case of an oral agreement, or an agreement partly oral and partly in writing, if the terms are disputed or ambiguous, the jury, under instructions from the court, determines not only what the parties said and did but also the meaning of the agreement. On the other hand, the meaning of every written agreement, and of any oral agreement in which the facts are undisputed, is determined by the court and not the jury.[1] In the process of harmonizing difficulties and inconsistencies in documents courts apply certain tests, sometimes spoken of as "rules of construction." These rules are not rigid rules of law, but merely rules of presumption based upon good sense and the teachings of experience. A bare statement of a few of these rules will sufficiently reveal their character.

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[10] F. Vaughan Hawkins, Esq., on *The Principles of Legal Interpretation with Reference Especially to the Interpretation of Wills*, in Juridical Soc. Papers, Vol. II, p. 298, at p. 329.

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[1] It will not escape the attention of the reader that the jury does not decide *all* questions of fact.

One of the rules of construction is that an argument is to be interpreted as an entirety, so that each part may shed light on the other parts. From this broad, general rule, which is founded upon plain common sense, there have been developed various subsidiary rules of construction. Thus, blunders of expression do not figure whenever the meaning is clearly to be ascertained from the general scope and expressed intent of the agreement as a whole. Again, although words are usually to be understood in their plain, ordinary, and popular sense, words which are shown by the context to have a technical meaning are given the proper technical meaning. So, also, "general words of release are always controlled by recitals and context which show that unless the general words are restricted the object and purpose of the document in which they occur must necessarily be frustrated."[2]

In many kinds of business dealings, the practice prevails of using printed forms which leave only certain particulars to be added in writing in each individual transaction. In such cases it has been said by an able judge that "where general words are used in a printed form which are obviously intended to apply, so far as they are applicable, to the circumstances of a particular contract, which particular contract is to be embodied in or introduced into that printed form, I think you are justified in looking at the main object and intent of the contract and in limiting the general words used, having in view that object and intent."[3]

A preliminary recital, stating the reasons for entering into the agreement, is permitted to influence the interpretation of the agreement only when the language of the granting clauses is doubtful. The rule has been stated as follows: "Where the recital in an agreement is so inconsistent with the covenant or promise that they cannot be harmonized, the latter, if unambiguous, must prevail, because it is the most important. The promise is what the parties agree to do and hence is the operative part of the instrument, while the recital states what led up

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[2]*Re Perkins* (1898), 2 Ch. 182, 190, per Lindley, M. R.
[3]*Glynn v. Margetson* (1893), A. C. 351, 355, per Lord Herschell.

to the promise and gives the inducement for making it. When the explanation of the reason for the promise is at variance with the promise itself, the latter, if clear and unambiguous, must prevail, as it is the transaction between the parties.''[4]

When a written agreement consists of both written and printed matter and these portions are in conflict, the part which is typewritten or in manuscript will govern the construction of the agreement. In many written agreements wherein a definite time for delivery is stated, there is also a printed clause that ''all agreements are contingent upon strikes, fires, accidents, or delays beyond our control.'' Even when this clause may be regarded as having been incorporated into the agreement,[5] it will, nevertheless, be lacking in efficacy if it be interpreted as inconsistent with the written part of the instrument.

§139. *Loss of Written Agreements.*—The loss or destruction of an unsealed writing has never been held, except in the case of a negotiable instrument, to extinguish the rights which are evidenced by it. It does not follow, however, that the disappearance of such a writing is always a matter of no consequence. Everybody knows that the loss or destruction of a writing frequently deprives the owner of his most convenient and convincing evidence. What is not so generally known is the pedantic extreme to which an occasional court will sometimes extend the so-called ''best evidence rule.'' According to this doctrine, one who wishes to establish the terms of a writing of any kind must ordinarily produce the original writing, or a duplicate original''[1] thereof, unless he is able satisfactorily to account for its non-production, in which case he is permitted to introduce sec-

[4]*Williams v. Barkley* (1900), 165 N. Y. 48, 57.

[5]It has been held that the presence of such printed matter above the letter-head of a sheet of paper upon which the agreement is written is not sufficient evidence of a mutual intent to incorporate it as a part of the agreement, unless the printed matter be referred to in the body of the agreement. *Summers v. Hibbard* (1894), 153 Ill. 102.

[1]A letter-press reproduction of a writing is held to be merely secondary evidence, but, by the weight of authority, a carbon copy is an original. *International Harvester Co. v. Elfstrom* (1907), 101 Minn. 263. Where a writing is drawn up in duplicate, or multiplicate, each party taking one of the parts, it is well settled that each of the parts is a "duplicate original."

ondary evidence (such as a copy of the writing or merely oral evidence). To satisfactorily account for its non-production, he must prove either that it is in the possession of the adverse party, who, after having been served with seasonable notice to produce it, declines so to do, or that it has been lost or destroyed without a fraudulent purpose. As regards a destruction voluntarily made by the owner, it is held properly enough that failure to produce the original will not be excused unless the owner repels every inference of a fraudulent design in the destruction. This is as far as this disciplinary rule can be extended without violating good sense, and yet there are a few extreme decisions to the effect that if the original has been lost or destroyed through mere carelessness the owner may not prove its contents by secondary evidence.

§140. *Alteration of a Written Contract.*—"No man shall be permitted to take the chance of committing a fraud without running any risk of losing by the event when it is detected."[1] This is the reason assigned at the present time for the rule that a fraudulent alteration of a written agreement of any kind discharges the obligations of all parties originally liable upon it, except one who has made or consented to the alteration.[2] According to its more recent development, however, the rule against alteration does not apply to immaterial alterations. An alteration is deemed immaterial whenever it does not change the legal effect of the writing; for instance, if it consists of the correction of a mistake in spelling, or the addition of words more specifically describing a person or thing named in the writing; or the insertion of such words as the law would imply.

Although material alteration of documents is properly frowned upon by the law, it seems plain on principle that alteration should have legal consequences only when the underlying reason for the rule so requires. The decisions on the whole recognize this limit to the operation of the rule. For instance,

[1]*Master v. Miller* (1791), 4 T. R. 320, 329, per Kenyon C. J.

[2]The Negotiable Instruments Law (§124) modifies this as follows: "But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor."

if a writing is altered with the assent of all parties, the document in its altered form is treated as valid.[3] Similarly, it is very generally held in this country, contrary to the English law, that an alteration in a writing made by a stranger is a mere trespass or spoliation, and without effect on the rights of the holder.[4] Alteration by the owner does not prejudice his rights if it was made accidentally or under a mistake of fact. The decided weight of authority in this country takes the same view even of an intentional alteration if the one claiming under the instrument is able to repel every inference of a fraudulent design on his part. For example, if the alteration is clearly proved to have been for the purpose of expressing the agreement more clearly or of correcting a real or supposed mistake, it would generally be treated as an excusable alteration.[5]

In case a material alteration has been fraudulently made, practically all courts in this country deny a recovery in any form of action either on the instrument itself or on the consideration for which the instrument was given. The relatively few courts which are committed to the doctrine that even an innocent alteration vitiates the instrument, grant a measure of relief to the innocent owner of the writing by permitting him to recover the value of any benefit which the other party has derived from the bargain.

PRACTICE PROBLEMS

(a) Action by landlord against tenant for rent due under the terms of a written lease of certain business premises. Prior to the execution of the lease the landlord had written defendant a letter stating that he would re-paint the building if the rent should be fixed at the rate stated in the lease instead of at a lower rate. Defendant entered into possession of the premises but left before the expiration of the term because of the landlord's refusal to paint the building. Is

[3]To avoid ground of suspicion, and to facilitate proof, such alterations in writing should be authenticated by the signatures or the initials of all the parties.

[4]The Negotiable Instrument Law unfortunately seems to embody the harsher English doctrine. See Neg. Inst. L. §124.

[5]The Negotiable Instruments Law apparently enacts that even an innocent alteration by the holder prevents recovery on a negotiable instrument, subject to the exception that a holder in due course may enforce it according to its original tenor.

the landlord's letter evidence which will be admitted by the court? See *Spear v. Hardon*, 215 Mass. 39.

(b) Suppose that at the time of the execution of the lease it had been orally agreed between the lessor and lessee that the lease should terminate in case the lessee should be unsuccessful in his negotiations for the purchase of the entire stock of goods of another dealer. Would this oral agreement be admissible in evidence when the lessor sues to recover rent under the lease?

(c) A, a manufacturer, submitted to B a typewritten offer to sell ten motor trucks of his make at a specified price, and stating a definite time for delivery. At the bottom of the first page on which this offer was made there appeared in fine type the printed clause, "All agreements are contingent upon strikes, fires, accidents, or delays beyond our control." The typewritten numeral denoting the first page of the offer was written over a part of this clause. After B accepts A's offer he wishes to know whether the printed clause will excuse A from liability for a delay in delivery caused by a strike. See *B. F. Sturtevant Co. v. The Fireproof Film Co.* (1915), 216 N. Y. 199. How can the printed limiting clause be unquestionably incorporated into the agreement?

(d) A and B made a contract which provided that A was to sell and B to buy one hundred tons of pig iron to be delivered in four equal monthly instalments. The contract was in writing, and required so to be by the Statute of Frauds. A found himself unable to make deliveries of the iron according to the terms of the agreement, and at his request B orally consented to extend the time for the delivery of the iron. Subsequently, however, B refused to live up to his oral promise, and maintained that he was free from liability of the original contract because A's non-compliance with its terms. What are the rights of the parties?

(e) A written construction contract contained a clause to the effect that no change made in the contract should be binding unless made in writing. Later the parties orally agreed that the builder should make certain changes in the contract and should receive additional compensation therefor. What are the rights of the parties?

§141. *Special Rules Applicable to a Contract by Deed.*—It has been the English law ever since the time of Henry II that the execution of a writing under seal, that is, a deed, gives rise to certain unique consequences. The superior validity of transactions effected by a deed may plausibly be defended on the ground that the solemnities and formalities which are requisite to its execution ensure a much higher degree of reflection and delib-

eration than are usually present in dealings of a more informal kind. In truth, however, it was the primitive formalism of mediæval English law which gave the deed its sanctity.

It is possible to use the deed for a great variety of transaction. Contracts of every description, transfers of property of all kinds, and the appointment of agents may be made in this form. On the other hand, however, the transactions which must be made by a deed are but few. As regards agreements, common-law doctrines required a deed only when an agreement was made without a valuable consideration. Such legislative enactments as have required a seal for certain other kinds of agreements have been merely sporadic in character, for, obviously, the most technical of all instruments is ill-adapted for ordinary business purposes. A conveyance of an interest in real estate is the only transaction which is rather commonly required by statutes to be made by a deed.[1]

According to legal nomenclature, a deed which imposes an obligation is a "specialty." A specialty may be either a "covenant" or a "bond." As lawyers use the word, a "covenant" is a specialty which contains a contract, that is, a promise by one of the parties, or mutual promises. A "bond" is a sealed obligation to pay money; generally it takes the form of an acknowledgment of indebtedness, with a provision that the obligation is to be void upon the happening of a specified event or the performance of a specified condition.[2]

At this point it is our purpose to consider, first, the formalities which are essential to the execution of a deed as such; and, second, the rules of law peculiar to contracts by deed. During the past century the subject has become one of ever-lessening importance, because in most jurisdictions the doctrines of the classic common-law as to the nature and effect of a contract under seal have been radically changed.

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[1]Inasmuch as this is the principal use of the sealed writing today, the word deed has come to mean in popular usage a sealed conveyance of real estate.

[2]If the sum mentioned in the bond is in the nature of a penalty, the obligation will not nowadays be enforced strictly in accordance with its terms. The maximum amount which the obligee may recover is the actual damage he has suffered from the non-performance of the condition.

§142. *Formal Requisites of Deeds.*—A deed may be wholly in writing or wholly printed, or partly in writing and partly printed. The instrument need not recite that the maker has affixed his seal to it.[1] Moreover, it is not necessary that it should be executed in the presence of, or be attested by a witness.[2] Probably the written signature which is so commonly affixed to this formal document as means of identifying the seal is not required by the common law. The one mark of a deed which distinguishes its appearance from that of other writings is the seal.

In the old days a seal on a writing consisted of wax impressed by the seal of the party executing the instrument. At the present time, however, this is deemed unduly cumbersome, and it is much more common merely to attach a gummed wafer to the paper. In the case of a corporation, the prevailing practice is to make an impression in the substance of the paper with the distinctive corporation seal, although it may adopt such seal as it pleases, if it is sufficient to satisfy the requirements for the seal of a natural person.

The common-law notion of what constitutes a seal has been markedly attenuated in many jurisdictions. In a number of states, usually as the result of legislation, a scroll, or any mark with the pen, if so intended, may serve for a seal. In these states the seal usually consists of nothing more on the paper than a printed impression purporting to be a seal; for instance, a printed circle containing the word "seal," or the letters "L.S.," (*locus sigilli*). Of all judicial modifications of the original notion of what constitutes a seal, the most striking decision is one which held that a single horizontal dash less than one-eighth of an inch long would answer for a seal, the context and circumstances showing that it was so intended.[3] In such jurisdictions

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[1]The rule is otherwise in Virginia and in a few other states. Moreover, it is held in several jurisdictions that any instrument to which a mere scroll has been affixed by way of a seal must purport to be sealed in order to constitute it a deed.

[2]In some states, however, statutes require the attestation of deeds which are used for the purpose of conveying land.

[3]*Hackers' Appeal* (1888), 121 Pa. 192. Of course no one should act on the assumption that he may safely use one of these novel modes of sealing, without first being sure of the law of his own state.

the private seal is no longer distinctive, and where this is true it may well be asked whether it would not be wise to do away with the use of private seals and abolish the distinction between sealed and unsealed writings.

In some jurisdictions individual, but not corporate, seals have been entirely abolished;[4] other states, while not doing away altogether with the individual seal, have abolished the requirement of a seal on a conveyance of real estate.[5]

§143. *Delivery of a Writing.*—According to a well-known formula, no document is effective as a valid deed unless it be "signed, sealed, and delivered." The formula is misleading in that a signature is probably not necessary, although a cautious person will prefer to follow the established practice and hence will sign his instruments under seal.

The sealing of a deed need not be the act of the one executing the instrument. If an adequate seal has actually been attached to the paper, no matter by whom, it may be adopted by the maker of the instrument as his own seal. As a rule, an intention to adopt the previously affixed seal is not so commonly expressed in words as by conduct. Whenever one of several parties has signed and attached his seal to an instrument which recites that the parties to it have affixed their seals, the decisions are almost unanimous to the effect that all subsequent signers presumptively adopt the seal of the first one as their own.

As regards the requirement of delivery, the existence of a declared intention on the part of the maker that the sealed writing is to be presently binding on him is the decisive consideration. All courts recognize, of course, that there must be some appropriate expression of such an intention. Whenever, as frequently happens, the maker transfers the physical possession of the instrument to the benefited party or to the latter's agent, and there is nothing to indicate an intention by him to retain dominion over the deed, his act of handing over the docu-

[4]Alaska, Arizona, Arkansas, California, Idaho, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, North Dakota, Ohio, South Dakota, Tennessee, Texas, Utah, and Washington.

[5]Alabama, Colorado, Georgia, New York, Rhode Island.

ment constitutes delivery. He may also manifest his intention that the deed shall become immediately operative by making a manual delivery of it to a third party for the benefit of the grantee or obligee. But may he also make a legal delivery without a physical delivery of the instrument to anyone? English law unquestionably permits a delivery "by acts without words, or words without acts, or both," but the English doctrine is not given the unanimous support of all American authorities, some of which hold that there is no delivery unless the maker actually relinquishes the control over the instrument.

Willingness on the part of the grantee or obligee to receive the deed is not at all essential to its validity, according to the English conception of a deed. Nearly all American courts, however, insist upon the necessity of acceptance by the grantee or obligee, and hold that until the instrument has been accepted it is merely inchoate. An unswerving insistence on the requirement of concurrent action by both interested parties obviously leads to an unsatisfactory result in certain cases in which a deed is intended as a conveyance of property by way of gift. Most of the American courts, therefore, do not require an actual acceptance in the case of a deed which confers a benefit. They profess holding that conclusively to presume an acceptance in such a case, which is, of course, merely a veiled way of making an exception to their general rule. In connection with business dealings, the requirement of acceptance is of little significance, inasmuch as business transactions, no matter in what form they are embodied, rest upon mutuality of assent.

§144. *Characteristics of Contracts Under Seal.*—At common law obligations under seal possess a validity superior to those embodied in unsealed writings. The ceremonial mode of incurring an obligation by the execution of a deed is attended by certain peculiar consequences. Unsuspected legal consequences are especially apt to arise in those cases in which the contract is a printed form of agreement with the letters "L.S." stamped upon it.

1. When the parol evidence rule was first established it applied only to sealed instruments, and, of course, it still applies

to them as well as to unsealed written agreements. There are, however, several distinctions which should be noted. It will be remembered that if an unsealed writing appears on its face to be an incomplete statement of the agreement, the matter in writing, though conclusive, is not exclusive; that is to say, its terms may be freely supplemented by the introduction of extrinsic evidence. On the other hand, however, no contract by deed which is incomplete on its face can be said to be under seal, although, of course, a new delivery of the instrument after the necessary additional terms have been incorporated in it will make the instrument binding in its altered form.

2. If an unsealed written agreement is delivered upon the condition that the agreement is not to take effect until the happening of some event or the fulfilment of a certain condition, the law in all cases will give effect to the intention of the parties. With respect to an instrument under seal, the law will not in every case effectuate the maker's declared intention, that the deed shall have no effect until a condition has been fulfilled. If the maker deposits his deed with a third person, who is to deliver it to the benefited party only upon the performance of a specified condition (such as the payment of money), the instrument is not a deed, but only a mere escrow, until the condition has been fulfilled. On the other hand, however, most of the authorities in this country hold that a deed cannot be delivered in escrow to the obligee or grantee. The rule that placing the instrument in the hands of the party to be benefited necessarily constitutes an absolute delivery and makes the deed binding, grew up at a time when the lawful possession of a deed by the benefited party was regarded as a fact of almost sacred significance. From the modern viewpoint such a technical doctrine is difficult to defend on principle, except possibly when it is limited to deeds conveying realty, although it is undeniable, of course, that to permit a condition to be annexed to a delivery of a deed when made to the obligee himself leaves "the very essence of the transaction to depend on the memory and truth of the bystanders."[1]

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[1] *Ordinary of N. J. v. Thatcher* (1879), 41 N. J. Law 403, 410, per Beasley, C. J.

3. Any agreement evidenced by an unsealed writing may be rescinded by a subsequent oral agreement and may also, except insofar as the Statute of Frauds is applicable, be modified by word of mouth or any other so-called parol evidence. According to the original common-law rule, however, a deed cannot be varied, rescinded, or discharged except by deed, there being an ancient maxim that every obligation under seal must be dissolved in the same manner in which it was created. In the course of time, however, the rule forbidding modification, rescission, and discharge of sealed contracts by subsequent parol agreements became overlaid with certain modifications and exceptions. These modern departures from the original technical rule are naturally not uniform in all states, and in a few jurisdictions a distinction is drawn between cases at law and those in equity.

4. The rules permitting the admission of extrinsic evidence to interpret an ordinary written agreement and to identify the parties to it also apply to deeds, except in one case. "Where a contract is made by deed, under seal, on technical grounds, no one but a party to the deed is liable to be sued upon it, and, therefore, if made by an attorney or agent, it must be made in the name of the principal, in order that he may be a party, because otherwise he is not bound by it."[2]

5. The loss or destruction or alteration of a deed in early times entailed a forfeiture. This follows logically enough from the common-law view that the document is the obligation itself, and not merely evidence of it, as in the case of an ordinary written agreement. Hence, when, as in one case, rats ate off the wax it was held that the instrument and the obligation were both gone. The obligation was regarded as "bound so indissolubly to the substance of the document that the soul perished with the body when the latter was destroyed or changed in its identity for any cause."[3] Equity, however, early gave relief against the hardship resulting from the innocent loss or destruction or alteration of a deed. In modern times the common-law courts in

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[2]*Huntington v. Knox* (1851), 7 Cush. (Mass.) 371, 374, per Shaw, C. J.

[3]*Bacon v. Hooker* (1901), 177 Mass. 335, 337, per Holmes, C. J.

such cases admit secondary evidence to prove the original terms of the deed, and enforce its provisions.

6. The time-limit during which an action may be brought on an instrument under seal is generally longer than that allowed in the case of an agreement made by word of mouth or by an ordinary writing. The statutory period of limitations for the latter class of agreements is usually six years. The period allowed for contracts under seal, although not uniform, is frequently longer, in some states running up to twenty years.

7. As regards contracts by deeds there is another respect in which a sealed writing has superior validity over obligations embodied in any other form. Whereas an executory promise made in any other way must be supported by a "consideration" in order to be enforceable, the common-law doctrine is that any promise under seal (save the exceptional one of a covenant in partial restraint of trade) is binding because of its formal execution.[4] Equity courts, however, have refused to recognize the solemnity of the sealed instrument as a sufficient reason for invoking their discretionary and powerful remedy of specific performance.[5] More recently there has been legislation in many western and southern states which has entirely abrogated all distinctions between sealed and unsealed written contracts. In a majority of these states it is further enacted that any written contract imports a sufficient consideration, but if lack of consideration is affirmatively proved the contract is invalid. In New York and a number of other states, there has been legisla-

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[4]If, however, the specialty was given for a promised consideration and there was a failure of the expected consideration, Chancery early gave relief by enjoining the obligee from enforcing the obligation and decreeing that he surrender the specialty or execute a release. Today there are probably statutes in all states in which there has been no fusion of law and equity, whereby failure of consideration, in common with fraud and other defenses based on equitable principles, may be set up as a defense to the action at law. See article by J. B. Ames on *Specialty Contracts and Equitable Defenses* in 9 Harv. L. Rev. 49.

[5]Dean Pound has pointed out that courts of equity are tending to get away from this doctrine and that there are cases in which "equity does enforce an executory promise on no other basis than declared intention plus a seal." See his article on *Consideration in Equity* in 13 Ill. L. Rev. 667 and his further comments on the subject in 33 Harv. L. Rev. 834-837.

tion somewhat less extreme in character, although modifying the common-law conception of the efficacy of a seal. In New York a sealed, but not an unsealed contract carries with it the presumption of a sufficient consideration.[6]

§145. *Legislation as to Seals.*—The legislation with reference to sealed instruments owes its popularity to the general belief that it is wise to change rules which are admittedly technical and the outgrowth of economic and social conditions which are now obsolete. It may well be questioned, however, whether it is not in accord with present-day convenience to have a formal instrument which carries in its train consequences of a different kind from those which attend writings of the informal sort. Is it not desirable, for instance, that there should be a mode by which even a gratuitous promise may be made binding? This is now an impossibility except in Massachusetts and a few of the other more conservative jurisdictions in which the ancient distinction between sealed and unsealed writings still prevails.[7]

PRACTICE PROBLEMS

(a) A father delivered what purported to be a gratuitous release in writing to his son who was indebted to him. The writing concluded as follows:

"Witness my hand this first day of May, A. D. 1916."

After the father's signature a scroll was made with the pen. Is the release binding?

(b) A made a promise under seal to pay B $2,000 on September 1. In consideration of the sealed promise B, at the time A made delivery of the instrument, orally promised to give A title and possession of his automobile on August 20. On August 15 the automobile was accidentally destroyed by fire. What are the rights of the parties?

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[6] It should further be noted that the New York legislation affects only executory transactions, and that a seal on a grant, release, or similar executed transaction still retains its full common-law significance in that state.

[7] It should be mentioned, however, that in New Jersey legislation similar to that of the New York statute above cited has been interpreted as not applying to any case in which the seal was used expressly for the purpose of making a gratuitous promise binding.

D. Capacity of Parties

§146 *THORMAEHLEN v. KAEPPEL.*

Supreme Court of Wisconsin, 1893. [86 *Wis.* 378.]

[This action is to set aside and cancel a certain mortgage executed by plaintiff to defendant during her minority, on her separate real estate, to secure a loan made by defendant to her husband. Other facts appear in the opinion.]

LYON, C. J.: Subject to certain conditions, it is a general rule of law that on becoming of full age a person may disaffirm his contract made during minority, and be relieved from the obligations thereof. One of these conditions is that he must so disaffirm within a reasonable time after attaining his majority. *O'Dell v. Rogers,* 44 Wis. 136, 138. Another condition is that if he has received and retains any part of the consideration for his contract he must return the same before he will be allowed to assert the invalidity of his contract because of his infancy when he made it. The latter rule was applied by this court, in *Callis v. Day,* 38 Wis. 643, and *Knaggs v. Green,* 48 Wis. 601. Still another condition of obtaining relief in equity is that the party asking relief has not fraudulently induced the other party to enter into the contract. Unless the plaintiff is subject to one of these conditions, she is entitled to the relief which the judgment gives her.

1. It is maintained on behalf of defendant that plaintiff did not disaffirm her contract expressed in the note and mortgage within a reasonable time after she reached her majority. She disaffirmed it within three and one-half months thereafter, and it does not appear that during such time the relation of the parties to the securities, or the value of the mortgaged land, materially changed. Within the rule of *O'Dell v. Rogers* (in which case a delay to disaffirm for nearly three years was held not unreasonable), we think the disaffirmance in this case was notified to defendant within a reasonable time after plaintiff became of age.

2. Counsel also maintains that the case is within the rule which, under certain circumstances, requires the party disaffirming his contract for infancy to restore the consideration paid by the other party. The difficulty with this claim is that the plaintiff never received any portion of such consideration, and hence has none of it to restore. It is argued, however, that because of a fact proved, but not stated in the findings, it ought to be held that in contemplation of law the plaintiff did receive and retains the consideration for her note and mortgage, and hence is within

the rule requiring a return to defendant of the money loaned. Such fact is that the money, or a large portion of it, loaned by defendant, for which the note and mortgage were given, was used to pay and discharge a debt secured by another mortgage theretofore executed by plaintiff upon the same land, and hence was paid for the benefit of plaintiff. The claim is that the mortgage in controversy should be held valid at least to the amount of the former mortgage thus discharged by such payment. The infirmity in the argument is that there is nothing in the proofs to show the existence of any condition which would render such former mortgage valid as against the plaintiff. It must be assumed that she was under no obligation to pay the debt it was given to secure in order to relieve her land from the lien of it. It was entirely a voluntary payment, and we are unable to perceive how the fact that such payment was made out of the money loaned by defendant can operate to make the mortgage in controversy valid.

3. It is further claimed that plaintiff was guilty of fraud because she failed to inform defendant, when she executed the mortgage, that she was a minor, or that the former mortgage was not valid as against her. We suppose, of course, that a court of equity would refuse to relieve an infant of his contract if his own fraud induced the other party to enter into it. But we do not think the authorities will sustain the court in holding that the mere failure of plaintiff to impart such information, unasked—there being no misrepresentation of fact, and no artifice employed to mislead the defendant—amounts to a fraud which would close the doors of the court against her.

By the Court.—The judgment of the circuit court is affirmed.

§147 *HALL v. BUTTERFIELD.*

Supreme Court of New Hampshire, 1879. [59 *New Hampshire* 354.]

Assumpsit, to recover for goods sold and delivered. The defendant pleaded infancy, and the question was reserved whether that was a bar to the plaintiffs' recovery. The defendant was engaged in trade, and the goods were purchased by him for the purposes of trade, and were not necessaries within the ordinary meaning of that term.

STANLEY, J.: The defendant interposes the plea of infancy as a bar to the plaintiffs' right to recover, and, so far as this right depends on an *express contract,* it is a complete answer. The express contract, on which the plaintiffs rely, was voidable at the defendant's election, but it does not necessarily follow,

because the defendant exercises his privilege to avoid the contract, that he is under no liability to the plaintiffs.

The right of infants, lunatics, persons *non compos mentis,* and drunkards, when in such a state as to be entirely deprived of reason, to avoid their contracts, is placed on the same ground. They are considered to be devoid of that freedom of will, combined with maturity of reason and judgment, essential to enable them to give the assent necessary to make a valid contract. To protect them from fraud and imposition, to which from their want of understanding and immaturity of judgment they are exposed, they are permitted to allege their want of capacity to bind themselves by contract. But this privilege is to be used as a shield, not as a sword; not to do injustice, but to prevent it. *Zouch v. Parsons,* 3 Burr. 1794; *Seaver v. Phelps,* 11 Pick. 304; *Allis v. Billings,* 6 Met. 415; *Hallett v. Oakes,* 1 Cush. 296; *Taft v. Pike,* 14 Vt. 405; *Lincoln v. Buckmaster,* 32 Vt. 652; *Matter of Barker,* 2 Johns. Ch. 233; *Sanford v. Sanford,* 62 N. Y. 553, 557; *Squier v. Hydliff,* 9 Mich. 274; *Spicer v. Earl,* 41 Mich. 191; *Allen v. Berryhill,* 27 Iowa, 540; Benj. *Sales, s,* 21; 1 Pars. *Cont.* 293; Chit. *Cont.* 135, 136, 141; 1 Fonbl., B. 1, c. 2, s. 4; Bing. *Inf.* 63; Ewell *L. C.* 588.

But while the disabilities of these different classes of persons and the reasons on which they are placed are the same, and they equally require protection, the application of the principles of law governing their rights and liabilities and their status has been widely different, and has undergone marked changes from time to time. Under the ancient common law, lunatics were allowed to show their lunacy in defense of their alleged contracts (2 Bl. *Com.* 291); but later, in the times of Edward III, "a scruple began to arise whether a man should be permitted to blemish himself by pleading his own insanity. Under Henry VI this way of reasoning . . . was seriously adopted by the judges, . . . and from these loose authorities, which Fitzherbert does not scruple to reject as being contrary to reason, the maxim that a man shall not stultify himself hath been handed down as settled law." 2 Bl. *Com.* 291, 292; Bac. *Abr.,* Idiots and Lunatics, F. The reason assigned for this maxim was, that a man cannot know in his sanity what he did when he was insane (*Stroud v. Marshall,* Cro. Eliz. 398; *Cross v. Andrews,* Cro. Eliz. 622); or, as stated by Littleton, "no man of full age shall be received in any plea by the law to disable his own person." Co. Litt., B. 3, 247 *b.* That such a doctrine ever could have been held to be law seems incredible, for, to use the language of Wilmot, J., it does seem to be very unaccountable that a man should be at liberty to avoid his own acts caused by the duress

of man, and not those caused by the duress of Heaven. Wilm. *Op.* 155; 5 Bac. *Abr.* (Bouv. ed.) 26. "How so absurd and mischievous a maxim could have found its way into any system of jurisprudence, professing to act upon civilized beings, is a matter of wonder and humiliation. There have been many struggles against it by eminent lawyers in all ages of the common law; but it is, perhaps, somewhat difficult to resist the authorities which assert its establishment in the fundamentals of the common law—a circumstance which may well abate the boast, so often and so rashly made, that the common law is the perfection of human reason." Story *Eq.*, s. 225. But this doctrine has been exploded as manifestly against natural justice (2 Kent. *Com.* 451), and it has been finally considered, in this and other jurisdictions, that lunatics and persons *non compos mentis* may show their incapacity as a defense to their contracts. Indeed, this doctrine seems now well established in this country. *Lang v. Whidden,* 2 N. H. 435; *Burke v. Allen,* 29 N. H. 106; *Mitchell v. Kingman,* 5 Pick. 431; *Rice v. Peet,* 15 Johns. 503; 5 Bac. *Abr.* (Bouv. ed.) 26; 2 Kent *Com.* 451, 452, and notes and authorities *passim.*

Again: it was formerly held that the contracts of lunatics and persons *non compos mentis* were absolutely void (*Thompson v. Leach,* 3 Mod. 301; *Gore v. Gibson,* 13 Mee. & W. 623; Chit. *Cont.* 24, 139); but this has been seriously questioned, and it is now held that they are voidable only (*Wait v. Maxwell,* 5 Pick. 217; *Allis v. Billings,* 6 Met. 415—S. C., 2 Cush. 19; *Ingraham v. Baldwin,* 9 N. Y. 45; Met. *Cont.* 80; Pars. *N. & B.* 151; 2 Hill. *R. P.* 408, s. 16); and that where a contract is entered into in good faith with a lunatic or a person *non compos mentis,* and is for the benefit of such person, courts of law, as well as equity, will uphold it. *McCrillis v. Bartlett,* 8 N. H. 569; *Young v. Stevens,* 48 N. H. 133; *Mut. Life Ins. Co. v. Hunt,* 79 N. Y. 541, *Hallett v. Oakes,* 1 Cush. 296; *Molton v. Camroux,* 2 Welsby H. & G. 487—S. C., 4 Welsby H. & G. 17; *Elliot v. Ince,* 7 De G. M. & G. 475; *Baxter v. Earl of Portsmouth,* 5 Barn. & C. 170; *Niell v. Morley,* 9 Ves., Jr., 478; *Brown v. Jodrell,* 3 Car. & P. 30; *Gore v. Gibson, supra;* 1 Pars. *Cont.* 386; Benj. *Sales,* s. 29; Story *Eq.*, s. 228. Greenleaf states the doctrine thus: Where goods have been supplied to a party which were necessaries, or were suitable to his or her station or employment in life, and which were furnished under circumstances evincing that no advantage of his or her mental infirmity was attempted to be taken, and which have been enjoyed by such party, then he or she is liable at law, as well as in equity, for the value of the goods. 2 Gr. *Ev.*, s. 369; *Kendall v. May,* 10 Allen, 62.

From this brief review, it is seen that there has been a change in the law relating to the rights and liabilities of lunatics and persons *non compos mentis,* from absolute liability upon all contracts to no liability upon any contract, and from that to a liability limited by the benefit received. This latter doctrine places their rights and liabilities upon broader, more rational and just grounds than they have ever been before, for it regards the rights of both parties—treats both parties to the contract as equally under the protection of the law—the lunatic and the person *non compos mentis,* by allowing them to rescind their contracts, accounting for the benefit received from it; the other party, by allowing him to recover to the extent of the benefit received by the lunatic.

The privilege accorded to infants to avoid their contracts rests on the same ground as that accorded to lunatics and persons *non compos mentis*—protection against fraud to which by reason of their immaturity of judgment they are liable. So far as relates to their contracts, these different classes of persons are said to be parallel, both in law and reason. *Seaver v. Phelps,* 11 Pick. 304; *Breckenridge's Heirs v. Ormsby,* 1 J. J. Marsh. 236; *Thompson v. Leach,* 3 Mod. 301; 1 Pars. *Cont.* 293; Story *Eq.,* ss. 223, 224, 242, and authorities *passim.* But the principles applicable to their contracts have not been the same, and even with regard to the contracts of infants the law has been materially changed. Under the decision in *Zouch v. Parsons,* 3 Burr. 1794, none of the contracts of minors were enforceable. They were all either void or voidable. Bac. *Abr.,* Infant I, 3; Com. *Dig.,* Enfant B. 5; *Lloyde v. Gregory,* Cro. Car. 502. But in *Zouch v. Parsons, supra,* it was held that infants were liable on their contracts for necessaries on the ground of necessity, and because they were of benefit to the infant. Lord Mansfield said, page 1801, "Great inconveniences must arise to others if infants were bound by no act. The law, therefore, at the same time that it protects their imbecility and indiscretion from injury through their own imprudence, enables them to do binding acts for their benefit. . . . A third rule, deducible from the nature of the privilege that is given as a shield and not as a sword, is, that it never shall be turned into an offensive weapon of fraud or injustice. . . . The end of the privilege is to protect infants. To that object, therefore, all the rules and their exceptions must be directed." In *Drury v. Drury,* cited in *Maddon v. White,* 2 T. R. 159, Lord Mansfield laid it down as a general principle, that if an agreement be for the benefit of an infant at the time, it shall bind him; and Buller, J., said Lord Hardwicke afterward adopted this rule. But this broad prin-

ciple announced by Lord Mansfield, and which seems so just and wise, and which secures to infants all the protection necessary to save them from the consequences of immaturity of judgment and understanding, has been limited so that under it they have only been held liable, upon an implied contract, for necessaries, such as necessary meat, drink, apparel, medicine, and instruction, and, if married, provision for wife and children. Bing. *Inf.* 87. Recently the term has been extended to include counsel fees, in cases involving their liberty. *Barker v. Hibbard,* 54 N. H. 539; *McCrillis v. Bartlett,* 8 N. H. 569. Formerly it was held by some authorities that they could not be allowed to rescind their contracts in regard to either personal or real property until after coming of age; but this has been modified, so that, as to their contracts in regard to personal property, they may rescind as well before as after. *Carr v. Clough,* 26 N. H. 289, 291; *Roof v. Stafford,* 7 Cow. 179; *Stafford v. Roof,* 9 Cow. 626; *Zouch v. Parsons, supra.* So they were formerly allowed to rescind, and recover what they had paid on their contracts without restoring what they had received. But this has been changed, and it is now held that they cannot rescind without restoring or offering to restore the consideration, if remaining *in specie,* and in the possession or control of the infant and capable of return; and in some jurisdictions it is now held, that where the consideration cannot be restored, the infant, before he can be allowed to rescind, must place the adult in as good condition as though he had returned the consideration or he must account for the value of it. *Carr v. Clough, supra; Heath v. West,* 28 N. H. 101, 110; *Locke v. Smith,* 41 N. H. 346, 353; *Young v. Stevens,* 48 N. H. 133, 137; *Heath v. Stevens,* 48 N. H. 251; *Kimball v. Bruce,* 58 N. H. 327; *Price v. Furman,* 27 Vt. 268; *Badger v. Phinney,* 15 Mass. 359; *Riley v. Mallory,* 33 Conn. 201, 207; Ewell *L. C.* 123, 125, 2 Kent *Com.* 236, 240; Benj. *Sales,* s. 27 note. This is especially the case in contracts for services, where the infant seeks to avoid his contract and recover what his services are reasonably worth; and this allows the adult to set off against the value of the plaintiff's services the reasonable value of what the infant has received on account of such services; or, in other words, the infant is entitled to recover for the benefit which the adult has derived from the services performed by him. *Lufkin v. Mayall,* 25 N. H. 82; *Locke v. Smith, supra; M'Crillis v. How,* 3 N. H. 348; *Vent v. Osgood,* 19 Pick. 572; *Stone v. Dennison,* 13 Pick. 1; *Breed v. Judd,* 1 Gray, 455; *Gaffney v. Hayden,* 110 Mass. 137; *Hoxie v. Lincoln,* 25 Vt. 206; *Harney v. Owen,* 4 Blackf. 337; *Squier v. Hydliff,* 9 Mich. 274; *Spicer v. Earl,* 41 Mich. 191;

Whitmarsh v. Hall, 3 Den. 375; *Makarell v. Bachelor,* Cro. Eliz. 583; *Ive v. Chester,* Cro. Jac. 560; Ewell *L. C.* 109.

Again: as has been shown, infants were formerly held liable on their contracts for necessaries; but it is now held that they are liable, not by virtue of any contract, but on the ground of an implied legal liability based on the necessity of the situation. Bing. *Inf.*, Bennett's notes, 87.

It is apparent that the tendency of the later decisions is to enlarge the liabilities and obligations of infants; and, while the liability has not in their case been extended so far as it has in regard to lunatics and persons *non compos mentis*, the principle on which it rests is the same. The grants of infants and persons *non compos* are parallel, both in law and reason. *Thompson v. Leach,* 3 Mod. 301; *Seaver v. Phelps,* 11 Pick. 304; *Breckenridge's Heirs v. Ormsby, supra.* In view of these facts, no reason appears why the wise and just principle enunciated by Lord Mansfield should not be given its full force, and the rights and obligations of lunatics, persons *non compos mentis,* drunkards when in such a state as to be entirely bereft of reason, and infants be placed on the same ground. The obligation to account only for the benefit actually received secures ample protection from fraud and imposition, and at the same time prevents the privilege from being used to perpetrate fraud. It prevents their disability from being "not their protection merely, but an extraordinary legal ability to rob others; not a shield, but a sword; not a mere legal incapacity to be plundered by their fellow-men, but a vast capacity to plunder them with impunity."

The right to recover for necessaries is given, because the infant has derived a benefit therefrom. It is upon no other ground. If the benefit is the foundation of the right, why should it be limited to necessaries? It cannot be said that the infant, if engaged in trade or business, may not derive a benefit therefrom. If benefit obtained by the infant is the test in one case, why not make it the test in all cases? This has been made the test in the case of lunatics and persons *non compos mentis,* and it should be applied in the case of infants. The true rule is, that the contract of an infant or lunatic, whether executed or executory, cannot be rescinded or avoided without restoring to the other party the consideration received, or allowing him to recover compensation for all the benefit conferred upon the party seeking to avoid the contract. The question whether the infant has received a benefit—like the question of what are necessaries, and what sum the infant ought to pay for them, or the question of negligence or ordinary care, and other similar questions—is one of mixed law and fact. No uniform rule can be established.

A contract, which under some circumstances to one person might be beneficial, under others and to another might be injurious. In no two cases are we likely to find the same facts; and it must always be for the trier to apply the law to the facts, and determine whether the infant has been benefited, and to what extent. Bing. *Inf.*, Bennett's notes, 88.

Our conclusion is, that the plea of infancy is not a bar to the plaintiff's recovery, but that they may recover to the extent of the benefit received by the defendant, not exceeding the price he agreed to pay for the goods.

BINGHAM, J., did not sit; the others concurred. *Case discharged.*

§148. *Minors: Disaffirmances.*—In some countries full age is fixed as late as twenty-five, but at the common law both men and women become of age (that is, attain legal capacity for all purposes) when they reach the age of twenty-one years.[1]

In matters which may be termed business transactions the law will not permit a minor, (or "infant," as he is called in law books) to bind himself. Such transactions, however, are not void of legal effect, but merely voidable.[2] Inasmuch as a minor is supposed to lack the judgment and experience and strength of mind possessed by normal adults, the law places the advantage entirely on his side. An adult who enters into a bargain with him cannot avoid the transaction on the ground that usually both parties must be bound or neither is bound to a contract.

A minor's contract or conveyance may be disaffirmed by him, even if the transaction was a fair one and there was every reason to believe that he was of full age.

Even innocent third parties cannot stand in the way of the

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[1]Rather curiously, it seems to be the prevailing view that a person attains his majority at the first moment of the day preceding his twenty-first birthday.

In some states the age of majority for women is fixed by statute at eighteen. In several states statutes provide that all that are minors, male or female, attain their majority by marriage.

[2]Early cases made an exception in the case of the appointment of an agent by a minor, which they held to be void. However, "the courts have from time to time made so many exceptions to the exception itself that there seems to be little left of it, unless it be in cases of powers of attorney required to be under seal, and warrants of attorney to appear and confess judgment in courts." *Coursolle v. Weyerhauser* (1897) 69 Minn. 328, 333, per Mitchell, J.

minor's right to avoid his business transactions. For example, the minor may exercise this privilege even after his promissory note or any property formerly owned by him has come into the possession of an innocent buyer who had no knowledge of the fact of infancy.[3]

Finally, in order to give a minor protection which is really adequate the law permits him to avoid not only the original transaction but also any ratification of it made during his minority.

§149. *Minors: Checks on Disaffirmance.*—The minor's claim to immunity from his bargain may be successfully asserted by him in various ways. Sometimes, of course, his privilege is set up merely as a defense to an action brought against him on his executory promises. In all such cases it is not necessary for him to do anything at all as a prerequisite to avoidance.

Sometimes, however, a minor finds it either necessary or expedient to initiate legal proceedings in order to recover back money or property formerly in his possession. In such a situation, return of the consideration received by him is required if he still retains the consideration, although there is much conflict as to whether he must return the consideration as a condition precedent to his action. On the other hand, if he has consumed or wasted the consideration which he originally received, it is held by the weight of authority that he is not required to make restitution in value in order to recover back what he has parted with. In a minority of states, however, he is denied a recovery of what he gave the other party (if it was a "provident, fair, and reasonable contract"), unless he should place the other party in *statu quo* by returning the equivalent of the benefit which he received, or by submitting to a deduction of the latter sum from the amount of his claim.[1]

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[3]The rule thus differs markedly from the one which prevails when rescission is granted because of equitable considerations.

In the case of sales of goods by a minor the law has been changed in those states which have adopted the Uniform Sales Act. This Act makes no exception to the doctrine that a *bona fide* purchaser for value from one who has a voidable title acquires a good title.

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[1]See *Johnson v. Insurance Co.* (1894), 56 Minn. 365.

A minor is entitled to avoid his contracts and conveyances of personal property at any time during his minority,[2] but his power to do so can be exercised even after he attains his majority. Nevertheless, the privilege of disaffirmance does not last forever. Disaffirmance will not be permitted if after the attainment of majority anything is done which operates as a ratification of the transaction. As will presently appear, the mere retention, after majority, of the consideration received, in certain cases results in terminating the privilege of disaffirmance.

The legal consequences of a disaffirmance are such as to discourage too free a use of the privilege. In the first place disaffirmance involves a disaffirmance of the transaction *in toto*. It is law as well as common fairness that a minor may not disaffirm that part of the transaction which is unfavorable to him and at the same time insist that the remainder is valid. Again, disaffirmance always invalidates the transaction *ab initio*. When once it is made, therefore, it is irrevocable even if it be made during the period of minority. To this limited extent even a minor cannot play fast and loose with the other party. Moreover, disaffirmance always confers the right on the other party to repossess himself of any of the consideration received by the minor and still in his possession (even in those cases in which the former does not have the right to insist on the return of the consideration as a prerequisite to avoidance).

§150. *Minors: Ratification.*—Since so-called infancy confers a privilege rather than imposes a disability, a minor cannot, as a rule, retain the freedom conferred by this privilege very long after becoming of full age. Upon attaining his majority he has at last arrived at a time when his assumption, and not merely his repudiation of liability for the bargain made while under age, is binding upon him. Henceforth, a ratification made by him will forever bar a subsequent disaffirmance, and will make the transaction binding *ab initio*.

[2]A conveyance of real estate by a minor cannot be disaffirmed by him during his minority. Even in this exceptional case, however, he may enter and receive the profits during his minority.

Ratification takes place whenever there are words or actions indicating an intent to renounce the hitherto existing power of disaffirmance. Intent to assume liability is as much a question of fact as intent to repudiate liability. If words are relied on to prove a ratification they must import more than a mere acknowledgment of the debt. They must express a promise or an intent to be legally liable for the original transaction.

The kinds of conduct which may constitute a ratification are indefinite in number; practically speaking, however, it is usually possible to group such conduct under one of a few sets of facts. It is doubtless partly for this reason that the jury's function in determining whether an intent to assume liability has been manifested has been somewhat limited by courts, and a number of hard and fast rules have been developed for the guidance of the jury. Thus it is held that ratification takes place when one sues on a contract he entered into during minority, or when one sells or otherwise deals as owner after full age with the consideration received during minority. The principal question in dispute is the effect which should be given to the mere acquiescence of the quondam minor after his majority. In the case of a bargain which remains entirely unexecuted on both sides, his silent acquiescence does not by the weight of authority constitute a ratification. If, however, property has been vested in the minor by virtue of the bargain, or the transaction took the form of a contract which involves continuous rights and obligations (such as a contract of tenancy, a contract of service, or a contract of partnership), the decided weight of authority holds that retention or continued receipt of the benefit for more than a reasonable time after becoming of age constitutes a ratification of the transaction. In the special case of a conveyance of real estate by a minor the authorities are divided, about half the states holding that mere acquiescence for a shorter period than that prescribed in the Statutes of Limitations does not bar the right to disaffirm.

Ratification by the one-time minor requires no formalities at common law. A few states, however, have statutes requiring the ratification to be in writing,—a form of evidence so advantageous in this particular class of cases that it should be secured

whenever possible, quite irrespective of any statutory requirement.

No consideration is necessary to make a ratification binding.

§151. *Minors: Torts and Crimes.*—The legal immunity of a minor is limited to contracts and conveyances made by him. A minor, if he is over seven years, may incur criminal liability for his acts.

Moreover, the general rule is that he is liable for his torts.[1] "If an infant commit an assault, or utter slander, God forbid that he should not be answerable for it in a court of justice."[2] In situations of this kind there is no good reason of policy why he should be exempt from liability. "The disability of a minor is to be used as a shield and not as a sword."

It is also well settled that a minor is liable for goods supplied to him if they are necessaries. That this is a quasi contractual, not a contractual, obligation, appears in various ways. Thus, the liability may exist even if the minor was too young to understand the nature of the transaction. Moreover, in spite of his promise to pay a certain price for the necessaries he is liable only for their reasonable value. Finally, it is significant that he is not liable upon an executory contract to buy necessaries.

§152 *GREGORY v. LEE.*

Supreme Court of Errors of Connecticut, 1894. [64 *Conn.* 407.]

[Defendant, a minor, leased a room while an undergraduate in Yale College, for forty weeks at $10 per week. He paid his rent regularly until December 20, when he repudiated the lease.] TORRANCE, J., said: "So long then as the defendant actually occupied the room as his sole lodging room it was clearly a necessary to him. . . The question now is whether he is

[1]In some states, however, an exception is made in case of a tort directly connected with a transaction which the minor would be entitled to avoid. Most of the cases in which this broad statement is made are cases in which the tort was a fraudulent misrepresentation of age which induced a contract or conveyance. The doctrine fails to distinguish between liability arising from contract and liability for a tort, and leads to results which seem unduly considerate of the minor.

[2]Lord Kenyon, C. J., *Jennings v. Rundall* (1799), 8 T. R. 337.

bound to pay for the room after December 20, 1892 . . . He cannot make a binding executory agreement to purchase necessaries."

§153. *Necessaries Furnished to Minors.*—To be necessaries the goods must pertain to the minor's person and not to his property or to his business. Moreover, the goods must not be for personal adornment or of a kind to contribute solely to pleasure. Some regard is paid for the minor's station in life, but in this country necessaries do not generally include much more than the creature-comforts (that is, those things necessary to keep him warm and well), and a common school, but not a college education. Moreover, the minor is not liable if he is already adequately supplied. Whether goods or services are necessaries is a mixed question of law and fact. Whether they can possibly be classed as such is a question of law; whether they were actually required by the minor in the particular case is a question of fact.[1] Since the burden of proof is upon the tradesman, it will be appreciated that any one who sells a minor any kind of goods whatever must be prepared to assume a very considerable risk.

In the New Hampshire case set out above it was held that a minor is liable to the extent of the benefit received by him, not exceeding the price he agreed to pay for the goods. Although these goods are, of course, not necessaries, it would seem to be only in accord with the principles of common honesty to hold the minor to a quasi contractual obligation in a case of this kind. It may perhaps be questioned, however, whether most courts are ready to apply the equitable principle relative to "unjust enrichment" to this situation. Under the statutes of some states, a minor who is carrying on a business of his own, is bound by all contracts connected with the business.

PRACTICE PROBLEMS

A, aged twenty, is engaged in business on his own account. He informed B that he was of full age and B, relying on this representation, sold A on credit the following goods:

[1] *Ryder v. Wombwell* (1868), L. R. 4 Ex. 32.

(1) 1 overcoat needed at the time by A. The reasonable value of the overcoat was $50, although the agreed price was only $40.

(2) 30 overcoats ordered for A's business. These overcoats were fairly worth $1,000, which was the purchase price. They were sold by A at retail for $1,400, which A immediately put back into his business, which prospered.

What are the rights of the parties?

§154. *Married Women.*—Under the common law the position of a married woman was a peculiar one. She was subject to unique disabilities, but at the same time there were certain unique presumptions in her favor in the case of her torts or her crimes. These peculiarities had their origin in the theory of marriage that prevailed when England was dominated by the military ideals of the feudal system. According to this theory the wife's personality was merged with that of her husband while the marriage state continued. It is often stated that the common law so far as possible treats husband and wife as one, but the practical effect of the common law rules was to make the husband that one. At common law the husband by the mere fact of marriage gained a very large interest in his wife's property.[1] Inasmuch as a married woman ceased to possess property, which could be bound by her contracts, the law, logically enough, deprived her of capacity to buy and sell or to make a contract of any kind.

In a more advanced, or at least a different stage of society, the results of these rules were deemed harsh, and accordingly equity with characteristic progressiveness provided a method of avoiding the common-law limitations imposed upon married women as regards the ownership and control of property. Equity recognized and enforced trusts for married women, so that whenever a settlement of property was made to the wife's separate use, she had a separate estate which was completely under her control. It was probably with this in mind that the Autocrat of the Breakfast Table advised young women contemplating

[1]A more specific description of the husband's legal marital estate would be of merely historical interest in view of the radical changes made by modern Married Women's Property Acts. For a non-technical treatment see Dicey, *Law and Opinion in England*, pp. 369-373.

matrimony, "Put not your trust in money, but put your money in trust." Property held in trust for a married woman for her sole and separate use was entirely free from the control of the husband (unless, of course, he should be trustee for the wife, in which case he would have the powers of any trustee). Equity permitted the wife to receive and spend the income of her equitable estate and to manage and sell it as if she were unmarried. Moreover, although she could not bind herself personally, she could charge her separate equitable estate not only by a contract for the benefit of the property, but also by a contract of any other kind in which she expressed an intention to charge the separate estate.

The process of judicial legislation by equity on behalf of married women reached its climax when equity was induced to enforce a settlement which stipulated that the interest of the married woman in her separate estate was not to be sold under any conditions and that any attempt by her to dispose of the income of the trust property before it actually accrued was to be void.[2] The reason for enforcing this restraint on alienation and on anticipation is the married woman's supposed need of protection against the cajolery or coercion of her husband.[3]

After equity had thus paved the way, the legislatures during the latter part of the nineteenth century vigorously entered upon the work of reform. Today there is probably no state without Married Women's Acts, designed to enlarge the legal rights and powers of married women. These statutes are the result of what has been termed a social revolution. They repudiate the common law principle of a unified administration of the property of husband and wife, and substitute for it the principle of individual independence. While many of these statutes go

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[2] "A married woman having an estate settled for her separate use without power of anticipation can play fast and loose to a greater extent than if she were a *feme sole*." *Lady Bateman v. Faber* (1898), 77 L. T. Rep. 578, per Lindley, M. R.

[3] In some states a trust may be created for the benefit of any beneficiary (other than the creator of the trust) for his life, with provisions that he shall be without power to alienate his right to the income and that the income shall be protected from the claims of creditors. For an authoritative treatment of this subject see Gray, *Restraints on Alienation*, 2nd ed. *Cf*, §29, *supra*.

far towards giving a married woman complete independence of her husband in respect to property rights, it is still rather common among the well-to-do classes to create trusts in favor of a married woman by means of deeds of settlements and elaborately drawn wills because, among other reasons, she may be restrained from alienating her separate equitable estate.

The American statutes vary widely in their terms. The more recent ones give the married woman complete independence of her husband as regards her property and power to contract. In some states, certain restrictions still exist in respect to her contractual capacity, but not infrequently these are for her advantage. This is obviously the case when the legislative restriction denies her the capacity of entering into contracts of suretyship, or of contracting with her husband.

The piecemeal character of legislation on this subject has, in all too many cases, created uncertainty and confusion on many of the points not expressly covered by legislation. Even when the legislation is uniform, or practically so, there exists an unfortunate diversity in the constructions that have been placed on the statutes, some courts having adopted a liberal attitude with regard to these statutory modifications of the common law, whereas most have rigorously applied the maxim that statutes in derogation of the common law are to be strictly construed.

§155. *DOLAN v. SCHOEN.*

Supreme Court of Pennsylvania, 1918. [261 *Pa. St.* 11.]

WALLING, J.: This is a taxpayer's bill to restrain the expenditure of public money. Pottsville is a city of the third class; and, at the beginning of 1916, its councilmen decided to remodel and improve the city hall. For such purpose $2,500 were included in the general appropriation ordinance for that year. An architect was employed to prepare plans and specifications, and thereafter, upon due advertisement, bids were submitted for different parts of the work, a tabulation of which showed that the improvement would cost nearly $2,000 more than the sum appropriated, and the bids were rejected. Then the council transferred the $2,500 to a contingent fund. Hiram S. Davies, a member of council, was superintendent of parks and public property, and as such took a leading part in this matter. He consulted with some who had submitted bids and with others,

took them to the city hall, and verbally explained what was to be done in the different branches of the work; secured new bids on such explanations without advertising, and ignoring the original plans and specifications. The mayor and council let contracts on such new bids, and the work was proceeded with. The improvement as so made cost about $2,000, and included new heating, lighting, and plumbing systems; also new partitions, stairs, doors, windows, etc. It also included some excavation and the construction of a new drain in the basement, and the removal of the tower; also plastering, painting, papering, etc. As stated by the court below:

"It consisted in the remodeling of the city hall; new rooms were added; bathrooms put in; staircases changed; hall built. In fact, the interior of the building was completely changed."

So far as appears the work was well, economically, and honestly done, and no fraud is alleged. However, plaintiff filed this bill to enjoin the city authorities from paying and the contractors from collection for the same, on the ground that the work had been illegally done. A preliminary injunction was granted as prayed for, which the court below made permanent after final hearing. Defendants appealed.

We are all of the opinion that the decree was right under the law. Section 5 of article 4 of the Third Class City Act of June 27, 1913 (P. L. 568, 576), known as the Clark Act, provides, inter alia:

"All stationery, paper, and fuel used in the council and in other departments of the city government, and all work and materials required by the city, shall be furnished, and the printing, advertising, and all other kinds of work to be done for the city, except ordinary repairs of highways and sewers and other public improvements, shall be performed, under contract to be given to the lowest responsible bidder, under such regulations as shall be prescribed by ordinance. . . . Council may by ordinance provide a contingent fund for necessary repairs or incidental expenses, not otherwise provided for in the general appropriations, and such funds may be expended without advertising for bids."

The work here was not done under contract given to the lowest responsible bidder. In fact, all the competitive bids had been rejected, and these contracts were let by private arrangement on different conditions. The claims cannot be sustained under the exception as to ordinary repairs, for the chancellor properly finds that the improvements in question were not ordinary repairs. Neither can they be included under the term "necessary repairs or incidental expenses." Council evidently

did not regard the improvements to the city hall as necessary repairs to be made from the contingent fund without advertising for bids, as they embraced that expense in the general appropriation ordinance and advertised for bids. True, as the chancellor finds, some of the work may properly be classed as ordinary repairs, but as that is blended with the other it cannot be made the basis for a separate claim. To hold that a contingent fund created to meet incidental expenses and necessary repairs could be used for the permanent alteration and remodeling of public buildings would practically abrogate this section of the statute. Council might have changed their plans and readvertised for bids, but they could not evade the law by the attempted creation of a contingent fund and by denominating the improvement necessary repairs. New partitions, new stairways, new windows, new entrances, etc., cannot pass as necessary repairs. While here no actual loss resulted, yet the statute requiring important municipal work to be open to competition is a valuable protection to the public, and cannot be ignored.

The provision stated in the above-quoted section is not new to the statutes of this commonwealth. It appears in the Wallace Act of May 23, 1874 (P. L. 230), and in subsequent legislation, and has been construed by this court. In *Mazat v. Pittsburgh*, 137 Pa. 548, p. 561, 20 Atl, 693, p. 697, it is held:

"It cannot be doubted that the true intent of the Act of 1874, and the ordinance passed in pursuance thereof, regulating the awarding of public contracts, is to secure to the city the benefit and advantage of fair and just competition between bidders, and at the same time close, as far as possible, every avenue to favoritism, and fraud in its varied forms."

See, also, *Louchheim v. Philadelphia*, 218 Pa. 100, 66 Atl. 1121. In considering a similar provision relating to cities of the second class in the very recent case of *Philadelphia Company v. City of Pittsburgh*, 253 Pa. 147, p. 151, 97 Atl. 1083, p. 1084, our Brother Mestrezat, in delivering the opinion of the court, says:

"We have uniformly held in numerous decisions, and it may now be regarded as the general rule in this state, that where the charter act of a city prescribes the method or formal mode of making municipal contracts, it must be observed, and, if not executed in conformity therewith, a contract is not enforceable against the municipality."

The assignments of error are overruled, and the decree is affirmed, at the costs of the appellants.

§156. *Government Contracts.*—Public contracts like that in above case, for reasons indicated in the opinion, form a highly complicated subject of great importance to certain classes of business. It is generally necessary to follow very closely the terms of a statute authorizing the public officials to enter into a contract. For a discussion of the public contracts of the United States see Shealey, *Law of Government Contracts* (1919).

E. Vitiation of Consent Element.

§157. *Mistake: In General.*—Our system of law must be said to be unduly severe in its insistence that ignorance or mistake is no excuse for wrongdoing. Even today it is the general rule that if one intentionally interferes with the person or property of another, his ignorance or non-negligent mistake of facts, making his act illegal, is no defense to him in civil proceedings. In some jurisdictions inroads have been made on the rule in the case of certain wrongs to the person, but concerning interferences with property, whether realty or personalty, the courts are practically unanimous in imposing an absolute liability upon the defendant.[1]

In the following discussion attention is directed exclusively to the effect of mistake on contracts and on transfers of property, since it is in dealings of this kind that it is especially important for the business man to realize the risks of ignorance and mistake. In view of what has been said of the law's attitude in the case of torts, it will perhaps occasion no surprise to discover that our legal system is somewhat backward with regard to extending such relief as is consistent with practicability to individuals whose acts have been induced by a mistake, especially if it be a mistake of law. The practical bearing of this for the man who has no desire to experience ''burnt fingers'' need not be emphasized.

§158. *Mistake Ordinarily Does Not Prevent Agreement.*—Underlying every bargain is an agreement. By agreement in a bargain, present-day law does not usually mean a true meeting

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[1]See an article on *Mistake in the Law of Torts* by Professor Clarke B. Whittier, in 15 Harv. L. Rev. 335.

of the minds. The law's standpoint is, on the whole, not subjective but objective. The obligations of an agreement are measured by the promisor's intention,[1] the test being, what is each party reasonably entitled to expect by virtue of the words or acts of the other?

A striking illustration of this principle is afforded by those decisions which hold that an offeree's acceptance of an offer received by telegram may be valid in spite of the fact that it was erroneously transmitted to him through no fault of the offeror but solely through the fault of the telegraph company.

§159 *AYER v. WESTERN UNION TELEGRAPH CO.*
Supreme Judicial Court of Maine, 1887. [79 *Me.* 493.]

[The offer as delivered to the offeree was to sell "800 M laths at 2 net cash," the word ten after 2 being omitted. This variation was not sufficiently great to prevent the offer from appearing to be correctly expressed to a reasonable man. Hence the court held that after the offer was accepted, the offeror was entitled to a remedy against the Telegraph Company for damages caused by its inaccurate transmission of the offer.]

§160. *When Does Mistake Affect Agreement?*—While the above case should not be regarded as embodying a rule which has received unanimous approval, it seems to be sound on principle, and it has the support of at least half of the authorities. If, in view of the position of the parties and all the surrounding circumstances, it can fairly be said that the parties expressed themselves with reference to one of the vital terms of the bargain in such a way that they have really said two different things, there is no agreement.

The situations in which the transaction is in this way rendered absolutely void as the result of a mistake are somewhat rare in occurrence. Perhaps the most common cases of this kind are certain cases in which the error relates to the identity of the other party to the bargain,—an error which is usually caused by fraudulent impersonation. Consider the effect of a mistake

[1] *Mansfield v. Hodgdon* (1888), 147 Mass. 304.

of this kind in the following two sets of facts. When a swindler obtains goods by appearing in person and pretending to be another, it has been held that the owner of the goods has manifested an intention to pass title to the swindler.[1] On the other hand, however, when a swindler obtains the goods by writing for them and using the name of another, it has been held that the owner, although parting with the possession, has not parted with his title, and hence even an innocent purchaser could acquire no right to the goods.[2] At first blush, these cases seem to be inconsistent with each other, but on analysis it appears that the decisions do not necessarily clash. In both cases the seller evinces a double intention when professing to transfer title, and since both of these intentions cannot be effectuated, the question arises as to which of the two is the dominant one. In the former case the swindler was identified by sight and hearing, and on this account it is not unreasonable to hold that although the seller manifested an intention to deal with the reputable party impersonated by the swindler, he also manifested an intention to deal with the man before him, and this was his dominant intention. In the latter case, however, the negotiations were entirely by correspondence, and this fact may well warrant the interpretation that, although the seller showed an intention to deal with the person who sent the offer, he also manifested an intention to transfer the property in the goods to the man of good credit and this was his dominant intention.

Less common is the case in which a mistake as to price is expressed in such a way that it operates to prevent the making of an agreement.[3]

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[1]*Edmunds v. Merchants' etc. Trans. Co.* (1883), 135 Mass. 283. The sale is of course voidable as against the defrauder or any person who is not an innocent purchaser.

[2]*Cundy v. Lindsay* (1878), 3 A. C. 459.

[3]*Rupley v. Dagget* (1874), 74 Ill. 351 is such a case.

Turner v. Webster (1880), 24 Kan. 38, is a case in which a contract of service was void because of a variation between the offer and the acceptance of it with regard to the element of compensation; inasmuch, however, as the plaintiff had rendered service in reliance upon the supposed contract the court required the party receiving the benefit of the services to pay "a just and reasonable price therefor." This result was reached, of course, by applying the principles of quasi contract.

Further illustrative material is to be found in those cases in which the parties have used ambiguous language in describing the subject-matter of their agreement.

§161 *RAFFLES v. WICHELHAUS.*

Exchequer, 1864. [2 *Hurl. and Colt.* 906.]

[Plaintiff sued for breach of alleged contract to buy cotton to arrive ex ''Peerless'' from Bombay. The defendant understood the agreement to refer to a ship ''Peerless'' which sailed from Bombay in October, whereas the plaintiff understood the agreement to refer to a different ship ''Peerless'' which sailed from Bombay in December. It was held that there was no contract.]

§162. *Reasonable Construction of Words Used.*—The same principle is applicable even in those cases in which the offeror uses language which is obviously ambiguous. Thus, for example, an offeree cannot insist on his own construction of an offer which was made by a cipher despatch ambiguous on its face.[1]

Mistake as to the very nature of the transaction also has occasionally such an effect upon the act of the mistaken party that it justifies his assertion that there was a failure on his part to express assent to the transaction. This may be true even though he attached his signature to a writing, provided he was not negligent and acted on the assumption that the writing was of a different character. Generally, of course, the inducing cause of such a mistake is a fraudulent representation of some kind by the other party, but what makes the transaction a nullity from the start so that even innocent third persons can acquire no rights under it, is neither the fraud nor the mistake as such, but the fact that no reasonable person present at the time of the transaction would have supposed that the defendant had expressed assent to an agreement of the kind it is now sought to charge him with.

§163. *FOSTER v. MacKINNON.*

Common Pleas, 1869. [*L. R.* 4 *C. P.* 704.]

[The payee of a bill of exchange secured the defendant's indorsement of it by keeping the face of the bill out of sight and

[1] *Falck v. Williams* (1900), A. C. 176.

telling the defendant that he was signing a guarantee. The court held that the instrument was a nullity even in the hands of a *bona fide* purchaser.]

BYLES, J.: It is invalid not merely on the ground of fraud, where fraud exists, but on the ground that the mind of the signer did not accompany the signature.

§164. *Negligence in Making Agreement.*—The great majority of the decided cases are in accord with this decision. The reason assigned by Mr. Justice Byles indicates perhaps that the court had not consciously as yet rejected the meeting-of-the-minds theory of agreement, but the correctness of the decision does not depend on this reasoning. The decision applies only to those situations in which the signer of an instrument did not know even the purport of the transaction, and the doctrine is limited to those cases in which the defendant acted with due care. If he was guilty of negligence in failing to ascertain the contents of the document, he will be precluded from denying its validity as against a purchaser for value without notice. It would seem that ordinarily he should be deemed negligent if he signed in reliance solely upon the representation of the fraudulent party.[1]

§165. *Equitable Relief Against Mistake.*—In the great majority of cases mistake does not operate to prevent the making of a bargain which is binding *at law*. Generally speaking, whatever relief is available to a mistaken party must be sought on grounds which are purely equitable in their essence.

The broadest statement of all, and one which should not be forgotten, is that a person is bound to take into account every circumstance having a bearing upon the bargain before expressing his assent to it, simply because his act is one which may affect important interests of the other party. For this reason,

[1]For one sort of case in which a jury is apt to find that under the circumstances such a signer was not negligent, see *Lewis v. Clay* (1898), L. J. Q. B. 224. Such is the situation in the usual case of a compromise or settlement between parties when the agreement is made with a full knowledge of the doubtful elements involved therein. It is a very different case when the compromise or settlement was expressly based by the parties upon a material fact regarding which both were mistaken. See, for example, *Wheadon v. Olds* (1838), 20 Wend. (N. Y.) 174.

whenever an element of doubt or risk is known to enter into the bargain, the risk assumed cannot be relieved against either at law or in equity.

It is true, nevertheless, that simple justice calls for a measure of relief against mistake in certain classes of cases. The rules which have been developed by the application of moral sense to particular cases involving mistake are discussed in the following sections. The effect of mistake is a question that comes up for consideration from the standpoint of equitable principles in various ways, and the rules relating to the subject vary somewhat according to the nature of the particular relief sought by the mistaken party. When is mistake a defense to a suit for the specific performance of a contract? When is it a ground for rescission of the contract? When is it the basis of a duty to make restitution on the doctrine of unjust enrichment? When is it a ground for the rectification of a written agreement? Does mistake of law afford a basis for equitable relief? These are the questions now to be considered in the order stated.

§166. *Refusal of Specific Performances on Ground of Mistake.*—Specific performance of contract is an extraordinary remedy, given only in the sound discretion of the court, and a court of equity is inclined to refuse this remedy, if in addition to a mistake by the defendant, there is in the situation an element of substantial hardship to the defendant.[1]

So also if the complainant was guilty of dishonorable conduct at the time of the transaction, he may be denied the special remedy of specific performance. This would be true, for example, if the complainant at the time knew of the defendant's mistake and yet made haste to "snap up the offer."[2]

When the defendant's mistake is due to his own carelessness, this fact is taken into account in the administration of the discretionary remedy of specific performance.[3]

§167. *When Rescission Is Granted.*—It is only in relatively

[1]*Mansfield v. Sherman* (1889), 81 Me. 365.
[2]*Webster v. Cecil* (1861), 30 Beav. 62.
[3]*Tamplin v. James* (1880), 15 Ch. D. 215.

few instances that the mistaken party is content with the measure of relief just discussed. In most cases, of course, he seeks to be relieved entirely from the transaction. In other words, he desires a rescission of the bargain and is not content merely to be free from the special obligation of specifically performing his agreement.

Various courses are open to one who is entitled to rescind the bargain. He may invoke the assistance of equity to have the agreement declared void, and the instrument embodying it cancelled; or he may wait until he is sued by the other party, and then set up his equity for the rescission of the transaction by way of defense. In the latter case also the remedy was originally sought in equity; but in modern times courts of common law have, in many instances, adopted the equitable principles of rescission, especially whenever chattels are involved.

The same facts which may be a bar to the remedy of specific performance are not always a ground for the rescission of the transaction. Disaffirmance of a contract which is binding at law is a remedy which should always be granted only under careful restrictions.[1] What are the special prerequisites to this mode of relief when it is sought on the ground that mistake has made the bargain unfair and unjust?

First of all, it must appear that the mistake relates to a matter actually contracted about. The line of division is usually stated to be between a mistake as to something intrinsic, such as the existence of the subject-matter of the agreement, and a mistake as to a matter which was extrinsic or collateral to the bargain. Errors of the latter kind include, as a general proposition, errors of judgment as to the attributes, the value or quality of the subject-matter of the bargain. Thus, in a sale of a specific chattel, a buyer who has neither an express nor an implied warranty of quality to fall back upon rarely has a case which entitles him to avoid the bargain.

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[1]The remedy of rescission as such is subject to certain conditions which are equally applicable whether it be given to the injured party on the ground of mistake or misrepresentation, duress, or undue influence. See §185, *infra*.

§168 *HECHT v. BATCHELLER.*

Supreme Judicial Court of Massachusetts, 1888. [147 *Mass.* 335.]

[Plaintiffs bought of defendants a promissory note unindorsed by defendants. Unknown to the parties, the maker of the note had made a general assignment for the benefit of his creditors two hours before this transfer. Relief was denied on the ground that the "mistake was not as to the subject-matter of the sale but as to its quality." Per MORTON, C. J.]

§169. *Essential Error; Mutual Mistake.*—Whether an error is one of the kind which is intrinsic, as it is called, should be recognized as a question of degree. On principle, and from the point of view of practical affairs, the inquiry should be: was the mistake actually the basis of the agreement as distinguished from matter of inducement for entering into the agreement? In other words, was the mistake such that it went to the essence of the contract and not merely to the motive?

In the second place, it has been frequently laid down that in the case of agreements, rescission will not be granted unless the mistake which went to the essence of the agreement was a mutual mistake. If a unilateral mistake was caused by, or known to the other party at the time the agreement was made, the courts will decree rescission, but if the unilateral mistake was unknown to the other party, the language of many cases supports the doctrine that the innocent party should not be deprived of the benefit of his bargain. Recently, however, there is a tendency to hold that it may be inequitable to allow an agreement to stand even when the unilateral mistake was unknown to the other party. Such was the decision in a recent Minnesota case[1] where a contractor's offer was lower than he intended because of his inadvertent omission to take account of an important item. Although the other party accepted the offer without knowing of the mistake, its acceptance of the offer did not lead to a change of position on its part, and on these facts the court decreed rescission and cancellation.

§170. *Recovery of Money Paid Under Mistake.*—Restitution

[1]*St. Nicholas Church v. Kropp* (1916), 135 Minn. 115.

in specie is peculiarly a remedy for a court of equity—the one court which can act *in personam;* restitution in value, on the other hand, is a mode of relief which courts of common law have, broadly speaking, long been able and willing to give against the defendant who is retaining a benefit which equity and good conscience demand should be restored to the plaintiff, whether the benefit consists of money paid or the value of services rendered or of chattels delivered.

The principle that restitution should be required of one who received a benefit the retention of which is unjust, applies when a defendant has received the value of labor and materials furnished him under a mistake of the kind which renders the agreement wholly void.[1] The principle, however, finds its most frequent application in situations in which a plaintiff has paid money under a mistake of fact. An English judge once said: "With respect to the argument that money cannot be recovered back, it seems to me, that wherever it is paid under a mistake of fact, and the party would not have paid it if the fact had been known to him, it cannot be otherwise than unconscientious to retain it."[2] Although the obligation to make restitution in such cases is commonly enforced today by means of a contract remedy (as distinguished from a remedy in equity), it is, of course, an obligation which is not at all based upon a promise or mutual assent of the parties and is, therefore, now commonly called a quasi contract.

The basis of the right in this kind of case is not the element of pure mistake but the obvious principle of justice that a person who has received from another a benefit, the retention of

[1]See, for example, *Turner v. Webster* (1880), 24 Kan. 38 and *Vickery v. Ritchie* (1909), 202 Mass. 247. In the latter case, the plaintiff recovered the fair value of his labor and materials, a sum very substantially in excess of the amount by which the market value of the defendant's property was increased.

[2]Rolfe, B., in *Kelly v. Solari* (1841), 9 Mees, & W. 54, 59. The statement quoted is too sweeping, as will appear in the subsequent discussion.

For a diverting story which supplies material for analysis and an opportunity for an application of the rules relating to mistake, see the chapter on "The Ransom of Mack" in O'Henry's "Heart of the West."

which is against good conscience, should be compelled to disgorge. This is evident from the fact that no recovery is permitted if the money was equitably due to the defendant. For example, a plaintiff who paid because of a mistake of fact as to whether the period specified in the statute of limitations had expired, cannot recover back his payment if he justly owed the debt. Is another illustration of this principle supplied by the rule that there can usually be no recovery by banks or drawees of bills of exchange who pay out money to innocent holders of instruments to which the drawer's name has been forged?

§171 *PRICE v. NEAL.*

King's Bench, 1762. [3 *Burr.* 1354.]

[Drawee sued indorsee, a holder in due course, to recover money paid under mistake as to the genuineness of the drawer's signature. Several reasons were assigned by Lord Mansfield in support of the decision that the drawee could not recover. One was expressed by him as follows: "If there was no neglect in the plaintiff, yet there is no reason to throw off the loss from one innocent man upon another innocent man."]

§172. *The Principle of Unjust Enrichment.*—While the rule of *Price v. Neal* is supported by the overwhelming weight of authority, the true explanation of the rule is a subject which is in great dispute.[1] From the standpoint of quasi contracts it seems impossible to formulate a theory of the case under which the several allied rules of law can all be explained in a mutually consistent way. It seems to be the prevailing view of the judges that "probably the rule was adopted from an impression of convenience rather than for any more academic reason."[2]

There are, however, unquestionably other situations in which a plaintiff who has paid money under a mistake is denied a recovery owing to a lack of equity in his favor. Such are the cases in which a defendant has been induced by reason of the pay-

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[1]For an able discussion of the conflicting theories on this point, see ch. V. of Woodward, *The Law of Quasi Contracts.*

[2]Holmes, C. J., in *Dedham Nat. Bank v. Everett Nat. Bank* (1901), 177 Mass. 392, 395. See also the remarks of Mitchell, J., in *Germania Bank v. Boutell* (1895), 60 Minn. 189, 193.

ment received from the plaintiff to give up property or to surrender a right against a third person, or has otherwise so acted in consequence of the payment that a return of the benefit conferred upon him would involve him in a sacrifice. Under such circumstances his "change of position," as it is called, gives him a defense except when his own negligence was the only or the principal cause of the mistaken payment—a rather uncommon situation.

The foregoing situations in which money may not be recovered, although paid under an admitted mistake of fact, sufficiently prove that the ultimate reason why a plaintiff who has paid money under a mistake of fact may ordinarily recover it back is not the element of mistake as such, but the principle of "unjust enrichment." The only effect of mistake in such cases is that it generally brings into play this wider principle of unjust enrichment. This conclusion is reinforced by the rule that no amount of mere negligence, in and of itself, deprives the plaintiff of the right to recover money paid under a mistake of fact, according to the decided weight of authority.[3]

It is not at all necessary to an action of this kind that the mistake be a mutual one, since it is obvious that frequently an unjust enrichment exists, although only the plaintiff was mistaken.

§173. *Mistake in Reducing to Writing.*—It is, of course, not within the power of even a court of equity to make agreements for people. If, however, the parties have really made an agreement, but there has been a mutual mistake in reducing it to writing, a court of equity, if certain conditions are complied with, will reform the written agreement, and in a proper case will decree specific performance of the reformed agreement. Of course, reformation will not be decreed unless the proof of the terms of the prior bargain is clear and convincing; for incautious action by equity in this respect would tend to defeat the whole object of reducing an agreement to writing.

It is usually a fundamental requisite of this mode of equit-

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[3]*Kelly v. Solari* (1841), 9 Mees. & W. 54, is the leading case.

able relief that mistakes due to oversight and precipitancy in reducing the agreement to writing be common to both sides. A mistake common to both parties is a requisite of the remedy of rescission; and certainly it is no less appropriate to insist on this requirement in granting reformation, since this involves not merely setting aside the instrument as it was executed, but also giving whatever further relief is necessary to the final adjudication of all rights involved.[1] Of course, if one of the parties knew of that mistake in the instrument at the time it was executed, this also is undoubtedly a case for reformation.

A second condition of the exercise of this discretionary power of a court of equity is so obviously in consonance with the general principles of equity jurisdiction that it requires no explanation. Equity will not reform a written agreement and enforce it in its corrected form unless the original instrument can be rectified without impairing the interests previously acquired by third persons on the faith of it.

Whenever a mistake creeps into the expression of a written agreement, only a court having equity powers may grant reformation; in other cases common law courts now occasionally undertake to exercise this delicate remedy. For example, in a sale by sample in which the sample has a latent defect unknown to both parties, a court of law will impose on a seller who is a manufacturer the obligation to furnish goods which will correspond to the sample as it would be if it were free from the secret defect.[2]

§174. *Mistake of Law.*—In rendering decisions judges are in no way liable even for glaring errors, and in their professional work lawyers are bound to know only so much law as may be supposed to be known to the reasonably competent practitioner. Laymen in their dealings, however, are held, broadly speaking, to the full measure of legal liability which would be

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[1]As to certain exceptional cases in which there was a decree for rescission or reformation at the option of the defendant, see Ames, *Cases on Equity Jurisdiction*, Vol. II, p. 242, note.

[2]The Uniform Sales Act extends this obligation to any seller who is a dealer in goods of the kind sold. See Sales Act, §16 (c).

imposed on one who could be shown to have had a perfect knowledge of the legal consequences of his acts. The rules relating to the professional activities of judges and lawyers are undoubtedly founded on a sound public policy. Is the same true of the rule governing the transactions of laymen? Should the law adopt as its standard the ruthless standard of nature under which no concession whatever is made to the individual who is ignorant of its laws?

In nearly every defense of this rule the statement is made that "every man must be taken to be cognizant of the law." The assumption, however, that this proposition is merely a corollary of the maxim, *Ignorantia juris non excusat* (ignorance of the law does not excuse) is plainly unwarranted inasmuch as this maxim is properly applicable only in the criminal law, or under statutes imposing quasi-criminal penalties. To the question why every man must be taken to be cognizant of the law, various answers have been given. Sometimes it is said that those who do not know the law have to be taught it, which can only be done by its enforcement. A more persuasive statement of the practical considerations of policy which are relied on to justify the orthodox view is that if "ignorance of the law were generally allowed to be pleaded there could be no security in legal rights, no certainty in judicial investigations, no finality in litigations."[1] It may well be questioned, however, whether this statement does not exaggerate the practical difficulties of administering the law on a different basis and one which would be intrinsically more just than the existing one.

As bearing on the question of the weight to be attached to the argument of policy, it is interesting to note that the distinction between mistake of law and of fact is generally unknown in countries which are governed by the Civil law.[2] Moreover, it is also significant that the rules in our own system of law under which mistakes are relievable in the various ways we have discussed, provided they are mistakes of fact, have not proved to

[1]Pomeroy on *Equity Jurisprudence*, Vol. II, Sec. 842.
[2]See note in Scott's *Cases on Quasi-Contracts*, pages 365, 366.

be insuperably difficult in their practical application nor unfortunate in their general consequences.

Disapproval of the doctrine which denies relief, even to the most careful of men, if the mistake under which he was induced to act is one of law, has been expressed by one judge in the following words: "No British or American judge ever attempted its defense on principle. It was ruled on policy, and followed upon the authority of a few precedents. A policy which, it must be conceded, does private wrong, for the sake of an alleged public good; or, I should more appropriately say, rather than risk a doubtful public evil."[3] In only two American jurisdictions, however—Connecticut and Kentucky—has the broad distinction between mistake of law and of fact been expressly rejected by the courts. In cases involving the reformation of a written instrument, courts of equity are substantially in accord in refusing to make a distinction between mistake of law and of fact. In cases involving other modes of relief, courts of equity, although really struggling against the orthodox rule, have been somewhat cautious about openly repudiating it; nevertheless, they evince their dissatisfaction with it plainly enough by their extraordinary astuteness in finding some other "equity," as it is called (such as fraud, misrepresentation, undue influence, or misplaced confidence) under which it becomes possible to them to grant relief. Moreover, courts constantly remind us that "the rule is not invariably to be applied," and thus prepare the way for a further whittling down of the rule. They are unanimous in regarding a mistake as to the law of another state or of a foreign country as a mistake of fact. Furthermore, some of them make a distinction between the general law of the country and private rights, considering a mistake as to a private right, even though it may be the result of a mistake of general law, as merely a matter of fact.[4] In Georgia the ingenuity of the judges has given rise to an additional distinction, namely, a distinction between mistake of law and ignorance of the law, relief being granted in the former case but not in the latter, on the

[3] *Culbreath v. Culbreath* (1849), 7 Ga. 64, per Nisbet, J.

[4] See the opinion of Lord Westbury in *Cooper v. Phibbs* (1867), L. R. 2 H. L. 149, 170.

ground that mistake of law is capable of proof, whereas mere ignorance of the law is not susceptible of proof.[5]

At the present time the situation in which the unfortunate distinction between mistake of law and of fact is most rigorously applied is when an action is brought to recover money paid under mistake. It was in an action of this kind that the distinction was first established.[6] Although equity, in administering other modes of relief, has succeeded to a considerable degree in retracing its steps to its original doctrine which made mistake of law ground for relief as well as mistake of fact, it has not unnaturally proved to be more difficult for courts to deviate from the famous case which is responsible for the existence of the distinction whenever this precedent is directly in point. Nevertheless, it is perhaps significant of the ultimate fate of the rule precluding recovery of money paid under mistake of law that certain exceptions are made to it. Thus the majority of courts hold that money so paid may be recovered back if the payment was made by a public officer or a public agent. Moreover, nearly all courts agree in permitting a recovery whenever the defendant is a court officer or an attorney at law.[7]

Thus far, however, only a few states—Georgia, Oklahoma, California, Montana, North Dakota, and South Dakota—have passed statutes making mistakes of law relievable, and these statutes limit relief to cases in which the mistake is common to both parties.

PRACTICE PROBLEMS

(a) R, in the course of an interview with C, asked for a loan. C consented to make the loan because of R's fraudulent representation that he was M, who was known to C to be a merchant in good standing in a neighboring city. Accordingly C gave R a check payable to the order of M. This check was indorsed by R in the name of M and the indorsee collected it from the drawee bank. Is the bank entitled to debit C with this payment?

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[5]This distinction is now incorporated in the Georgia Code.

[6]See the vigorous opinion of Lord Ellenborough in the leading case of *Bilbie v. Lumley* (1802), 2 East 469.

[7]"The Court, then, finding that he [its officer] has in his hands money which in equity belongs to some one else, ought to set an example to the world by paying it to the person really entitled to it." *Ex parte James* (1874), L. R. 9 Ch. 609, 614.

(b) R, by falsely representing himself to be the agent of B, induced S, on B's credit, to ship wool billed to B. When the wool reached its destination R induced the railroad to make delivery of it to him on his false representation that he was B's agent. Thereupon R sold and delivered the wool to B, and after receiving the cash for it, absconded. What are the rights of the parties? See *Rodliff v. Dallinger*, 141 Mass. 1.

(c) A's secretary, B, submitted a number of circular letters to A for the latter's signature. The writing on each letter filled almost the entire sheet, so that there was barely room for A's signature. B arranged the letters so that A saw the contents of only one letter, this letter covering all of the one underneath it, except the space at the bottom reserved for A's signature. Each of the other sheets successively covered the one underneath it in the same way. B had fraudulently substituted a promissory note payable to his own order for one of the letters. A signed all of the papers without examining the same, being assured by B that they were identical with the one on top. B indorsed the note to C, who paid full value bona fide and without notice of the fraud. Can C hold A?

(d) A made an agreement with B to buy the latter's business on the basis of an inventory. The price thus determined was $20,000, which A paid in cash. Later B discovered that items amounting to $1200 had been omitted from the inventory. What are his rights?

(e) A agreed to serve B as a watchman for one week, B promising to pay "$1.50 a day and nights the same." A understood this to mean $3 for twenty-four hours' service. It was B's understanding, however, that A was to have only $1.50 for that number of hours. A performed the services night and day for a week. What are the rights of the parties? See *Turner v. Webster*, 24 Kan. 38.

(f) A, a holder in due course, presented for payment to B, a bank, a check containing several indorsements, one of which was forged. B paid the check and upon discovering the forgery contends that it is legally entitled to recover back the amount paid A. Is the bank's contention sound? See *Corn Exchange Bank v. Nassau Bank*, 91 N. Y., 74.

(g) The so-called parol evidence rule is not allowed to stand in the way of reforming a written agreement; will the Statute of Frauds prevent reformation when the prior bargain of the parties, although within the purview of the Statute, was only orally expressed? The authorities are in a state of great confusion. See Clark on *Equity*, sections 348-350.

§175. *Fraud.*—An individual's freedom of action in playing upon the motives of men in conducting negotiations with them, or in directing and supervising them, is restricted in three

directions. He must not use (1) misrepresentation and fraud, nor (2) duress or coercion, nor (3) undue influence. We shall consider first misrepresentation and fraud.

A distinguished economist has put the problem in these words: "As long as men are free to choose for themselves and act according to their own judgments, those who are shrewd and watchful will make better bargains than those who are dull and unobservant. When does one man overreach another, when does he simply leave him to judge for himself as to his own interests? The probabilities are that for the sake of securing the large general benefits that flow from private property and competitive dealings we shall always have to permit some doings that are on the line between the productive and the predatory."[1]

Our problems are to find out what must be shown by the injured party in order for him to make out a case of misrepresentation or fraud and what he can do about it, so far as legal remedies are concerned. Misrepresentations, whether innocent or fraudulent, may operate to prevent the making of an agreement. Cases of this kind have been dealt with under the head of mistake. Usually, however, misrepresentation is merely a ground for the granting of relief from an existing agreement—relief which is given in accordance with equitable principles. As regards the remedy of reformation it will be remembered from the discussion of the topic of mistake, that the remedy is given not only when there is a mistake common to both parties, but also when by reason of mistake on one side and knowledge of it on the other, the written agreement is an incorrect expression of the prior bargain. In the subsequent discussion it will appear that even innocent misrepresentation is a bar to the remedy of specific performance, and that there is a strong tendency in modern times to treat it as a ground for rescission. Finally, it will be pointed out under what circumstances a misrepresentation may be the basis of a tort action.

§176. *Active Misrepresentation.*—It is a general principle in our system of law that one is under no duty to act for another's advantage except when he has made a binding promise

[1]Taussig, *Principles of Economics*, ch. 2, §5.

so to act or is in a special relationship, such as that of parent and child, and master and servant. In accordance with this general principle there is ordinarily no duty to disclose facts of any kind to the other party of the transaction.

§177. *SMITH v. HUGHES.*

Queen's Bench, 1871. [*L. R.* 6 *Q. B.* 597.]

[The plaintiff, a farmer, sold oats by sample to the defendant, who thought he was buying old oats. New oats were useless to him. In an action for the price, the jury found for the defendant, under a direction of the court that they were to find for the defendant if the plaintiff knew that the defendant believed the oats to be old oats. A new trial was ordered on the ground that this direction to the jury was not correct. BLACKBURN, J., said: "Whatever may be the case in a court of morals there is no legal obligation on the vendor to inform the court held that the instrument was a nullity even in the hands of the vendor."]

§178. *Exceptions to Rule Requiring Active Misrepresentation.*—There are, however, certain exceptions to the general rule. In contracts of marine insurance even the innocent nondisclosure of any fact affecting the risk is a ground for avoiding the contract.[1] This duty of disclosure embraces not only such facts as are known to the insured, but also those which he ought to have known about. This special rule is said to be based on the ground that such contracts are peculiar in that one of the parties usually has means of knowledge which are not available to the other, and that hence it would be unfair to treat the parties as though they were bargaining upon an equal footing. Further, whenever parties stand in a special fiduciary relation to each other, a full disclosure of every material fact affecting the transaction is invariably required by the law. Typical illustrations of such fiduciary relations are those existing between partners, principal and agent, lawyer and client, guardian and ward, trustee and beneficiary, and promoters and the corporation. These are all cases in which the parties are not supposed to be

[1]With respect to contracts of fire and life insurance, most American courts hold that only a fraudulent concealment is fatal to the contract.

dealing with each other at arm's length. Finally, it is to be noted that in certain situations non-disclosure has been held fatal to a suit for specific performance of the contract, while not constituting a defense to an action at law for breach of contract, or even a ground for rescission in equity. It has been so held in the case of an expert's contract to buy land from an ignorant farmer who did not know the mineral value of his land, and in the case of an improvident contract with a woman who was inexperienced in business. In cases like this a court of equity invokes the equitable maxim, that he who comes into equity must come with clean hands,—a rule of elastic, and not always predictable application.

Even as to ordinary transactions between strangers, there is one further comment to make. If an offeree receives what he knows to be an erroneous expression of the offer, he cannot, even by a categorical acceptance, hold the offeror to the terms of the erroneously expressed offer.[2] When a person knows that his *promise* is misunderstood by the other party, the consequences may be even more unfavorable to him, for he will probably be precluded from denying that his promise has the meaning attached to it by the other party. In the case of *Smith v. Hughes,* to which attention was previously directed, Mr. Justice Hannen said: "If, in the present case, the plaintiff knew that the defendant, in dealing with him for oats, did so on the assumption that the plaintiff was contracting to sell him old oats, he was aware that the defendant apprehended the contract in a different sense to that in which he meant it, and he is hereby deprived of the right to insist that the defendant shall be bound by that which was only the apparent, and not the real, bargain."[3]

§179. *The Elements of Injury and Reliance.*—Even an active misrepresentation must be the cause of injury to another before it becomes a matter of legal consequence. "An action can-

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[2]*German Fruit Co. v. W. U. Tel. Co.* (1902), 137 Cal. 598. An offer to sell Riverside oranges of a standard grade was wrongly transmitted by telegraph so as to read $1.60 a box instead of $2.60. It was held that the offeree had notice on the face of the telegram of the error and therefore could not accept the offer in the form in which it was delivered.

[3]*Smith v. Hughes,* §177, *supra.*

not be supported for telling a bare, naked lie."[1] No relief is granted to a man who disregarded a misrepresentation and acted on his own judgment. He need not show, however, that the misrepresentation was the sole, or even the predominant, inducement for entering into the agreement. It is enough if it formed a material inducement. In this respect fraud differs markedly from mistake as a ground for relief on equitable principles. A mistake as to some matter of inducement is insufficient to avoid an agreement—there must be a mutual error regarding a matter actually contracted about.

If the misrepresentation has actually induced action it is generally held, and very properly, too, that extreme credulity, or failure to investigate, or even negligence on the part of the injured party is immaterial. Massachusetts is one of the very few jurisdictions in which this doctrine is not fully accepted. Even in Massachusetts, however, the defrauded party is not deprived of his remedy if he has been reasonably cautious. In a recent Massachusetts decision it was said: "It is too late in the history of law to argue successfully that reasonable reliance upon representations which turn out to be fraudulent must go without relief because the sharpest distrust might have discerned the wrong. It is no ground for not affording relief to the plaintiffs that it would have been possible for them by constant and suspicious watching to have discovered that they were being defrauded. So long as they acted reasonably they have a right to protection."[2]

The next question which naturally arises is, Who is entitled to rely upon the misrepresentation? Not every Tom, Dick, and Harry is entitled to act upon a representation. This right belongs only to those who may fairly claim that the statement was made with the intent that it should influence their conduct.

§180 *PEEK v. GURNEY.*

House of Lords, 1873. [*L. R.* 6 *H. L.* 377.]

[Plaintiff bought shares in the open market upon faith of a prospectus containing misrepresentations of fact. The prospec-

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[1]Buller, J., in *Pasley v. Freeman* (1789), 3 T. R. 51, 56.
[2]*Forbes v. Thorpe* (1911), 209 Mass. 570, 577, 578, per Rugg, C. J.

tus had been issued by the defendants to induce subscriptions to the original issue of stock. It was held that the plaintiff was not so connected with the representations made in the prospectus as to render the defendants liable to indemnify him against the losses which he had sustained by reason of his purchase.]

§181. *Indirect Communication of Representation.*—The representation need not, however, be made by direct and personal communication. Thus, a seller may reasonably rely on statements made by the buyer to a commercial agency. The buyer must be taken to have intended this result inasmuch as the only purpose of the agency is to give its customers information as to credits.

§182. *Materiality of Fact.*—In connection with the requirement of reliance courts have developed certain rules as to what kind of statements may be regarded as properly forming an incentive to action.

Cheating exploits are frequently carried out successfully by the use of divers "points of cunning," as they are called by Bacon in his essay on Cunning. Most of these devices are beyond the reach of the law inasmuch as they generally consist of nothing more than taking advantage of men's humours and their impressionability to laudations and rosy prophesies. We all know, as Stevenson reminds us in *Virginibus Puerisque,* that to tell truth, rightly understood, is not to state the true facts, but to convey a true impression, and that truth in spirit, not truth to letter, is the true veracity. It needs no long argument, however, to make it clear that practical considerations prevent the law from insisting on more than truth to facts.[1]

It has, therefore, been crystallized into law that when parties are dealing on a basis in which each one is supposed to look after

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[1]The following interesting comment on the prospectus of a recently organized oil company is taken from the columns of a financial journal: "The authors of this document appear to have gone on a perfectly sound psychological principle that if you bludgeon a man with facts—'cold hard facts,' statistics, financial statements, and the like, nine chances out of ten he won't stop to look into the facts any further, but will take your conclusions as proven. It is interesting to the student of advertising psychology as showing a new trend in oil stock publicity, but to the man who is merely trying to make money out of stocks it has little practical appeal."

his own interests, neither a statement of law, nor of opinion, nor of intention, nor of expectation, nor of prediction will be ground for legal liability. And, of course, equivocations and oracular remarks form an insufficient basis for action in the eye of the law. As a rule, "puffing," "tips," and "seller's talk"[2] may be indulged in endlessly with impunity. It was said by Sargent, J., in *Page v. Parker*,[3] "No action will lie for a false representation by the vendor concerning the value of the thing sold, it being deemed the folly of the purchaser to credit the assertion, and besides, value is a matter of judgment and estimation, about which men may differ." There are cases in which gross misrepresentation as to value, combined with great hardship, constituted a bar to the discretionary remedy of specific performance, but these cases are few and far between.

§183 *SCOTT v. HANSON.*

Chancery, 1826. [1 *Sim.* 13.]

[An estate sold at auction was inaccurately described as consisting of *uncommonly rich* water meadow land. It was held that a meadow which was watered, though imperfectly, was not improperly described as a water meadow and also that the words *uncommonly rich* referred merely to the quality of the land. LEACH, V. C., said: "In that sense, it professes to be nothing more than the loose opinion of the auctioneer, or vendor, as to the obvious quality of the land, upon which the vendee ought not to have placed, and cannot be considered to have placed, any reliance. The purchaser must therefore complete his contract."]

§184. *False Representation, a Question of Fact.*—The line between misrepresentations of opinion and misrepresentations of fact, however, cannot be sharply drawn. Thus a misrepresentation of a rule of law, if made by a lawyer to a layman, or of opinion by one who assumes to have expert knowledge, may, if relied upon, be sufficient ground for avoiding the transaction. It is not unreasonable to rely on such statements.

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[2]Sometimes seller's talk is treated as immaterial, although the statement is one of fact; for instance, a misstatement by the seller of the lowest price he will accept, and in many jurisdictions a misrepresentation as to the price he paid for the article.

[3](1861) 43 N. H. 363.

As regards a statement of intention, if a promisor makes a false representation as to his existing intention, this should be treated as a statement of fact. "The state of a man's mind is as much a fact as the state of his digestion."[4] Accordingly, it is held (except in Pennsylvania), that buyers of goods on credit who intend at the time not to pay for them are guilty of fraud. It must be said, however, that many courts have shown reluctance to extend this doctrine beyond this particular class of cases.

When once it is established that there has been a lack of veracity as to facts, the mode of conveying the false impression is entirely immaterial. In this respect courts have been careful in their definition of fraud not to commit themselves in such a way that they would be embarrassed in dealing with novel forms of fraud.

Anything beyond non-disclosure,—it may be a mere shrug of the shoulders, or a facial expression,—may by possibility constitute a misrepresentation of fact and even actionable fraud. Moreover, courts very sensibly hold that there may be "a lie which is half the truth." It goes without saying that it is fraud to produce an erroneous impression by taking active steps to prevent the truth from being known, as when a manufacturer skillfully conceals a defect in the manufactured article.

The way in which a court approaches the problem was well expressed by Lord Halsbury, in a case involving a prospectus: "I should say, taking the whole thing together, 'was there false representation?' I do not care by what means it is conveyed—by what trick, or device, or ambiguous language; all those are expedients by which fraudulent people seem to think they can escape from the real substance of the transaction. If by a number of statements you intentionally give a false impression and induce a person to act upon it, it is not the less false, although if one takes each statement by itself there may be a difficulty in showing that any specific statement is untrue."[5]

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[4] *Edington v. Fitz Maurice* (1885), 29 Ch. D. 459, 482, per Bowen, L. J.

[5] *Aaron's Reefs v. Twiss* (1896), A. C. 273, 281.

§185. *Limitation on Equitable Rescission.*—In the great majority of cases, misrepresentation, whether innocent or fraudulent, does not prevent the formation of a contract. Usually it merely creates the motive for consenting to enter into the transaction. This is also true of transactions induced by mutual mistake or duress. Each of these factors, therefore, is a ground for rescinding a contract, a sale of goods, or any other consensual transaction.

The right to set aside a transaction in these situations is based solely upon consideration of simple justice. It follows that rescission will not be granted unless its consequences will be consistent with a just result. For instance, if a fraudulent party succeeds in securing the owner's assent to the transfer of the title to goods, and not the mere possession of them, an innocent purchaser for value of the goods from him will not be disturbed. Again, it is held that if the misrepresentation which induces a bargain is the act of a stranger, rescission may not be had (assuming, of course, that the party to the bargain who reaped the benefit did not abet the misrepresentation and that it was a case of "one beats the bush, and another has the hare"). In short, it is perhaps safe to generalize that if a dispute is between parties who are equally meritorious, the one having a legal right may insist that things remain in *statu quo.*

The equitable nature of the right of rescission in cases of this kind makes it necessary that the party seeking this equitable relief should himself do equity. "If you are fraudulently induced to buy a cake you may return it, and get back the price; but you cannot both eat your cake and return your cake."[1] Ordinarily, therefore, rescission will be withheld unless the defendant can be and is restored to his original position. This is not, however, a hard and fast requirement, and it need not be complied with by the plaintiff if he has left nothing undone which he could do to put the defendant in *statu quo,* and if his inability to accomplish this has not resulted in an advantage to himself.

In a voidable, as distinguished from a void transaction, unless

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[1] *Clarke v. Dickson* (1858), A. B. and E. 148, 152.

and until the injured party manifests an intention to avoid the bargain, it remains in force. Although he is entitled to rescind, he may waive the right. He loses his right to rescind if, after discovery of the misrepresentation, he does anything by word or act to confirm the transaction; for example, if he accepts a benefit under the transaction, or even if he fails to exercise his right to rescission with reasonable promptness after discovering the misrepresentation.

As regards the rescission of a contract, the right is usually exercised by the injured party when he is purely on the defensive in an action of contract against himself. If property has been secured through misrepresentation, and the property is of a sort requiring formal transfer of title, such as land or shares of stock, equity alone is able to grant rescission. A reconveyance in such cases requires a decree *in personam*, and this is a remedy which only an equity court can give. In the case of sales of chattels, however, it is not necessary that the transaction should be set aside by special judicial proceedings of any kind. Thus, a defrauded seller may retake the goods without legal action if he can do so peaceably. Moreover, even when he decides, through choice or necessity, to forego his remedy of self-help, he may bring an action to recover the value of the goods or an action for the goods themselves without having previously secured an adjudication as to his equitable right to the goods. In the converse case, a defrauded buyer of goods may at once sue to recover the full price he paid. Here also it is assumed that rescission does not require special legal proceedings.

§186. *Damages for Fraudulent Misrepresentation.*—In defenses to actions of contract, or in actions to set aside conveyances or contracts the authorities are gradually committing themselves to the proposition that the misrepresentation of fact need not be a fraudulent one. In controversies of this description, equitable doctrines are applied and as a rule it is inequitable for one to claim an advantage obtained by even an innocent misrepresentation.

Suppose, however, that an untrue statement caused injury, although it led to no consensual transaction with the maker of

the representation, or suppose an injured buyer wishes to affirm his purchase provided he can recover compensation for the injury done him by the misrepresentation; or suppose that because of a failure to act with reasonable promptness after discovery of the misrepresentation or because of the intervention of rights of innocent third parties, equitable interference with the transaction will be denied: in all of these cases the injured party expects to be given an action for damages resulting from the misrepresentation. Unfortunately, however, such an independent action for damages will not lie, according to the common law, unless the misrepresentation was dishonestly made.

§187 *DERRY v. PEEK.*

House of Lords, 1889. [14 *A. C.* 337.]

[The defendants were directors of a tramway company which was authorized to use steam power upon receiving the consent of the Board of Trade. In issuing a prospectus the directors called attention to the right to use steam power as one of the important features of their undertaking. In fact, however, the consent of the Board of Trade had not been given and was later expressly refused. The court interpreted the facts with leniency towards the defendants and found that the prospectus expressed their honest belief. *Held,* that the circumstances did not make out a sufficient case for an action of deceit for damages, even though there was no reasonable ground for the belief of the defendants.]

§188. *Motive and Intent in Misrepresentation.*—By this decision the House of Lords established the rule in England that although in almost all other forms of human action a man is under the duty of exercising reasonable care not to do harm to others, he is under no such duty in making statements intended to induce action on the part of other people. From the standpoint of justice such a doctrine is utterly indefensible. It is, moreover, inconsistent with the law governing misrepresentation when relied on as the basis either of an estoppel or of an action of warranty.[1] Fortunately, the rule is not followed in some American jurisdictions.

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[1]For an exposition of this topic, see two articles by Professor Williston: *Liability for Honest Misrepresentation,* in 24 Harv. L. Rev. 415; *Representation and Warranty in Sales,* in 27 Harv. L. Rev. 1.

The existing disinclination of judges to follow this rule is not always expressed in their summaries of the requisites for actionable misrepresentations. Sometimes it appears more clearly in connection with what they hold to be a *fraudulent* misrepresentation. If a man makes an untrue representation in reckless disregard of whether it be true or not it is plainly a fraudulent misrepresentation. So also if he asserts a fact as true of his own knowledge when he has no knowledge (although he may believe the fact to be true). But in Massachusetts and in other states the courts have not stopped at this point, but have held that an unqualified statement of a material fact susceptible of actual knowledge involves the assertion of knowledge of the fact, and if this knowledge is known not to exist, there is fraud by the one making the representation, notwithstanding his belief in its truth.

A bad motive on the part of the defendant is not required in order to make his representation fraudulent in point of law. Even those courts which make conscious dishonesty an indispensable element in liability for misrepresentation recognize that a man may make statements which he knows to be false, although he may have no desire at all to injure the plaintiff, or even to make a profit for himself.[2]

Where goods are wrongfully taken by force, or by theft, the tort has a twofold effect, namely, injury to the owner and benefit to the wrongdoer. The courts have therefore held that the owner may either bring a tort action for the damage suffered by him, or he may "waive the tort" and recover whatever money was realized from a sale of the goods by the wrongdoer. And although there is authority to the contrary, the better rule is that even if the goods are retained by the wrongdoer, restitution will be enforced by means of an action for the value of the goods. For the same reason, a defrauded seller, instead of reclaiming the goods or bringing an action of deceit for damages, is usually

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[2]*Polhill v. Walter* (1832), 3 Barn. & Adol. 114. Since 1912 the False Statement Law in New York makes it a misdemeanor for one who seeks credit, knowingly to make a false statement in writing as to his ability to pay, although his purpose is merely to bolster up his credit. Similar legislation has been enacted in several other states.

permitted to demand restitution. But, through a confusion of substance with the form of the action, the weight of authority denies him the remedy of restitution when the goods were sold on credit and the period of credit has not expired.

PRACTICE PROBLEMS

(a) A statute prescribing the terms and conditions on which foreign corporations may do business, required, among other things, that every foreign corporation should file with the Commissioner of Corporations a certificate setting forth its financial condition. Defendant, who was manager of a foreign corporation, filed such a statement with knowledge that it was false. Plaintiff, on the faith of an examination of this statement in the office of the Commissioner of Corporations, sold goods to the corporation and bought shares of stock in it. Shortly afterwards the corporation became insolvent. Has the plaintiff a cause of action against the defendant?

(b) Defendant is treasurer of a corporation whose shares are actively dealt in between stock brokers. The corporation, with the defendant's knowledge, entered into an important contract whose effect would be to enhance substantially the value of its shares. The defendant did not wish knowledge of the contract to reach the public until it had first been given to all the directors. A broker who had heard rumors of the contract asked defendant whether they were true, giving as the reason for his inquiry that the truth with respect to this rumor would influence his customers in their decisions as to whether to buy or sell shares in the company. The defendant answered that he knew of no such contract. The broker reported this to the plaintiff, one of his customers, who at once sold his shares in the company, which he did only because he believed the statement made by the defendant to the broker to be true. Later, when news of the contract was published, the price of the shares of the company advanced greatly. Has the plaintiff a cause of action against defendant?

(c) B applied to L for a loan, offering as security a note purporting to be signed by X and Y. L declined the loan unless W would say that Y's signature was genuine. W, though really having no knowledge or belief as to the genuineness of Y's signature, wished to help B and believed that X was fully able to pay the note. Accordingly, W assured L that Y's signature was genuine. In fact, Y's signature was forged. Y was readily accessible by telephone, but L, relying on W's statement, made the loan without further inquiry. X and B became insolvent and L now sues W for deceit. What judgment?

§189. *Duress and Undue Influence.*—Duress is generally exercised by means of threats. As in the case of misrepresentation

and fraud, the injured person's action is voluntary. Since, however, his consent was given only to avoid an alternative which the other party had no right to impose, he may avoid the transaction by complying with the usual requisites for a rescission. In essence, therefore, duress is an equitable defense.[1]

Until recent times, the test of what threats would constitute duress was fixed by reference to an external standard. This practice was established in early times, when the defense of duress (although really equitable in its nature) was recognized by the courts of law. Originally the standard was the constant and courageous man; today, however, courts which still apply an external standard say that an improper threat constitutes duress if it is calculated to break down the resistance of a person of ordinary firmness. With such a method of approach to the problem it was natural that courts of law should develop certain more or less wooden rules as to what particular kinds of conduct would constitute duress. Thus until recent times it was necessary for the injured party to prove threats of a kind which would create a reasonable fear of loss of life, or of great bodily harm, or of imprisonment of his person. The defense was not available if the wrongful pressure consisted of unlawful control of property. At the present time, however, the prevailing tendency is to abandon external standards altogether. The more recent decisions are disposed to emphasize the essentially personal nature of the defense, holding that relief should be given even to the exceptionally timid person, provided he did in fact succumb to improper threats.

The modern test is not only inherently just but also has the advantage of flexibility. It is known to every one that new ways of applying wrongful pressure to the will of another are constantly being invented. For example, threatened injury to a man's business in a form of pressure which is being increasingly applied as business is becoming more specialized and more interdependent.

That two adults were not on an equal footing at the time the bargain was entered into, is not in itself a ground for relief.

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[1]The only exception to this is the case in which a wrongdoer uses physical compulsion to direct the hand of another in signing a writing.

Merely because one entered into a bargain reluctantly and under the lash of financial necessity, or because the other party made ungenerous use of his ability to force a hard bargain does not make out a case of duress, unless the pressure of economic necessities was caused by the wrongful act of the person in the superior bargaining position. Threat of a mere civil suit, moreover, even if such a threat is effective, seems never to be regarded as sufficient to constitute compulsion. If, however, threat of legal proceedings also carries with it the risk of irreparable injury or immediate hardship to the business of the one threatened, it is held to constitute duress.

Whenever money has been paid or goods conveyed under wrongful pressure constituting duress, the law imposes an obligation to make restitution whenever the retention of the benefit is inequitable. In such cases the obligation is quasi-contractual in character, courts of law having acquired their jurisdiction under the fiction of an implied promise.

Duress is always a rather gross means of inducing consent. There are, however, other means of overreaching and directing the will of another which, though more subtle and refined, are treated as equally wrongful by a court of equity. The law books refer to these modes of unfair dealing as "undue influence." The principle has been stated as follows: "Whenever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed."[2] A person may be under a special duty either by reason of confidence having been reposed in him, or because he is in a relationship, either parental or fiduciary, which subjects him to a special law-imposed duty. In the former class of cases, the one alleging

[2] *Tate v. Williamson* (1866), L. R. 2 Ch. 55, 61 per Lord Chelmsford.

undue influence has the burden of establishing the existence of this element; but if there is a parental relationship, the burden of proving the entire fairness of the transaction to a court of equity rests upon the parent, and the same presumption of undue influence is applied to the dealings of certain fiduciaries, namely, attorneys, trustees, executors, promoters, and, in some jurisdictions, directors of a corporation and employers of minors.

PRACTICE PROBLEM

The plaintiff, a dealer in ice, was under a contract to furnish ice each week-day to important customers. Early one morning, when his teams were loaded with ice ready to start on the day's deliveries, defendant, having brought an action on a promissory note made by plaintiff, attached the horses and wagons, and informed the plaintiff that none of the property attached could go unless the claim should be settled by the payment of $300. The plaintiff urged that he had received a discharge in insolvency which discharged the claim, and said he would dissolve the attachment by giving a bond. The defendant replied that the discharge in insolvency did not cut off the claim and that it would take three days to dissolve the attachment. Thereupon, being in fear of great loss to his business, plaintiff paid defendant $300 under protest and as a means of relieving his property from attachment. If plaintiff can prove that defendant had no legal claim, but made the attachment for the purpose of extorting money from the plaintiff, does he make out a good cause of action for the recovery of the $300 he paid? See *Chandler v. Sanger* (1874), 114 Mass. 364.

F. Legality of Object

§190 *LAMSON BROS. v. BANE.*

U. S. Circuit Court of Appeals, Eighth Circuit, 1913.
[124 *C.C.A.* 121.]

SMITH, C. J.: The defendant in error, I. W. Bane, is a lawyer engaged in the practice of his profession at Des Moines, Iowa, and will hereafter be called the "plaintiff." Lamson Bros. & Co. are composed of L. J. Lamson, W. A. Lamson, and L. F. Gates, and will hereafter be called the "defendants." They have for a considerable period been engaged in business at Chicago, Ill., as brokers and commission merchants. They maintained branches in 14 Iowa cities, one at Des Moines, where three men, including a manager, were employed. The Des

Moines office received considerable sums of money, which were deposited in a bank in that city, and notice was sent directly to the Chicago office of the amount of these deposits and to whom they should be credited. On December 27, 1909, the plaintiff entered into a contract through the defendants' manager at Des Moines for the purchase of 100 shares of M. K. & T. stock at 48¼, and after being notified that the stock had been purchased he paid $500 as a margin upon it. On January 8, 1910, he similarly contracted to buy 100 shares of Wabash preferred at 57¼, and after being notified that the stock had been purchased paid as a margin thereon the sum of $600. Subsequently he from time to time deposited other sums of money to meet declines in the market until his total deposits amounted to $3,800, including $500 deposited at Chicago while there. Both M. K. & T. stock and Wabash preferred were listed at the Stock Exchange in New York, but neither of them was so listed at Chicago.

When the plaintiff authorized the purchase of the 100 shares M. K. & T. stock, the defendants' manager or agent at Des Moines wired them at Chicago to purchase the stock. Defendants telephoned J. J. Townsend & Co., of Chicago, to make the purchase, and they wired to Sternberger, Sinn & Co., of New York, to make the purchase, and upon their reply that they had done so, Townsend & Co. notified the defendants, they sent the news to their Des Moines agency, and it was there delivered to the plaintiff, and he then paid $500 as a margin.

On February 4th, this stock having fallen, the defendants notified J. J. Townsend & Co. to sell the same. They in turn notified Sternberger, Sinn & Co., who reported that they had sold the stock at 39¾. In a similar way when the plaintiff gave his order for the purchase of 100 shares of Wabash preferred the defendants' agency at Des Moines telegraphed the home office at Chicago, which telephoned J. J. Townsend & Co., who in turn wired Sternberger, Sinn & Co., at New York, to purchase the stock. They wired back to J. J. Townsend & Co. that the order had been complied with and the stock cost 57¼. They notified the defendants by telephone, who wired the information to their Des Moines agency, which notified the plaintiff, and thereupon he deposited a margin of $600.

On July 26, 1910, the defendants telegraphed to S. B. Chapin & Co., of New York, to sell the Wabash preferred. They telegraphed back that it had been sold at 30¼. This left a balance due the plaintiff on the defendants' theory of $58.64, for which they sent him a check.

It is the theory of the plaintiff that these were mere gambling transactions, that there was no intention that these stocks should

ever be delivered to him, and that if the defendants bought stocks they were "hedging" against loss on their wager.

Under the general law, if these were wagers the plaintiff could not recover the money lost thereon, and this is conceded to be the law of Iowa. Code 1897, §§4967, 4968; *Counselman & Co. v. Reichart,* 103 Iowa, 430, 72 N. W. 490; *People's Savings Bank v. Gifford,* 108 Iowa, 277, 79 N. W. 63.

But certain states have believed that gambling could be better suppressed by providing that money lost in gambling may be recovered, among them New York, California, Tennessee, and Illinois. . . .

Assuming that under the Illinois law these were gambling contracts, it then becomes material whether the contracts are governed by the laws of Iowa or of Illinois.

It must be borne in mind that it is the contention of plaintiff that these were gambling contracts, and that he did not in fact buy the M., K. & T. and Wabash preferred, but that he in effect made a wager that the stock would go up against the defendants' wager that it would go down and what the defendants did, if anything, in the way of buying such stock, or an option thereon, was a mere "hedging" against loss, with which he had nothing whatever to do. Consequently, upon his theory the contract was never to be performed or executed in the sense of buying the stock, and the court properly charged the jury that:

> "If you find that defendants never intended to deliver the actual stock to the plaintiff upon the payment of the purchase price, and you should then find that defendant did purchase stocks as it did for the purpose of 'hedging' or protecting itself, then the fact that the defendant purchased stock in New York City would not avail it, and there would be no defense here." . . .

The undisputed evidence is that whatever this contract was, whether a contract for future delivery, as it purported to be, or a gambling contract, plaintiff went to the defendants' manager at Des Moines and there authorized the purchase of the stock in question; the defendants' agent, claiming it was a *bona fide* purchase, wired the Chicago office. Defendants wired back, not to plaintiff, but to their agent at Des Moines, that the purchase was made. The Des Moines agency so notified the plaintiff at Des Moines and he there paid the 10 per cent. margin.

Importance is attached to the fact that the wire from Chicago to Des Moines was to the defendants' agent and not to the plaintiff.

It is plaintiff's theory that the defendants' agent at Des Moines did not have general authority to close the contract.

Let it be so conceded. Plaintiff, nominally at least, ordered the purchase of the M., K. & T. and Wabash preferred. This he did with the Des Moines and not directly to the Chicago office. The Chicago office sent no message to the plaintiff, but sent a message to its agent at Des Moines. Thus far the transactions tending to a contract were wholly between the plaintiff and the defendants' agent at Des Moines. There was nothing in that to constitute an agreement. The Des Moines agent then told the plaintiff the stock had been bought and plaintiff put up his margin. That closed the contract at Des Moines. There was no evidence of legal acceptance at Chicago. . . .

If the Des Moines agency had no authority to make the alleged wagering contract with the plaintiff and had telegraphed the home office, and it in turn had telegraphed directly to the plaintiff that his proposition was accepted, and he had then gone and paid the first margin at the Des Moines agency, there would be room for the contention that the contract was closed when the defendants delivered the telegram for transmission at Chicago; but, taking the most favorable view of the case for the plaintiff, if this was a wagering contract, and if the Des Moines agency had no authority to make it and telegraphed to Chicago and the defendants there decided to accept the contract and so telegraphed the agency at Des Moines, and that agency notified the plaintiff and took his money, the contract was consummated at Des Moines, and under the policy of Iowa the plaintiff could not recover even though he afterwards paid upon the contract a subsequent margin at Chicago.

There being no evidence that the contract was accepted in Illinois, within the meaning of the instruction given by the court, it was necessarily error to submit that question to the jury, and the case is reversed and remanded, with directions to set aside the verdict and grant a new trial.

§191. *Public Policy and Games of Chance.*—After all, which is the better way to check gambling: by leaving the parties where the law finds them, or by stepping in to restore a *status quo?* The common law has developed the notion: *in pari delicto melior est conditio defendentis.* In recent times, however, tendencies to depart from this doctrine in the interest of justice have appeared, not only in the statutes with reference to gambling transactions, but also in the judicial tendency to allow a very considerable *locus penitentiae* (room for repentance) where a contract against public policy has not been fully consummated. *Cf.* Woodward, *Quasi-Contracts,* §152.

§192. *Resale Prices.*—Agreements to fix resale prices have been held void because in restraint of trade and repugnant to the Sherman Anti-Trust Act of July 2, 1890, even in the sale of goods manufactured under a secret process. *Dr. Miles Medical Co. v. John D. Park & Sons Co.* (1911), 220 U. S. 373. If, however, a manufacturer sells a patented device with the restriction that it should be used only with other supplies, not patented, made by the manufacturer, and a defendant sells supplies to a purchaser of the device, knowing they would be used in violation of this condition, it was held in *Henry v. A. B. Duke Co.* (1912), 224 U. S. 1, by a divided bench (4 to 3) that the action of the defendant constituted contributory infringement of the patent. Justice Lurton, in delivery the opinion of the court, said: "The property right to a patented machine may pass to a purchaser with no right of use, or with only the right to use in a specified way, or at a specified place or for a specified purpose—there is no difference, in principle, between a sale subject to specific restrictions as to the time, place or purpose of use, and restrictions requiring a use only with other things necessary to the use of the patented article purchased from the patentee. If the violation of the one kind is an infringement, the other is also."

§193. *Price Restriction on the Resale of Chattels, Note in* 33 *Harv. L. Rev.* 966.—" . . . Two recent cases[1] before the Supreme Court of the United States have raised again, in somewhat different form, the question of attempted price maintenance on the resale of chattels—condemned in the well-known case of *Dr. Miles Medical Co. v. Park & Sons.*[2] In each of these late cases a manufacturing corporation was indicted under Section 1

[1] *United States v. Colgate & Co.*, 250 U. S. 300 (1919); *United States v. A. Schrader's Son, Inc.*, U. S. Sup. Ct. No. 567, Oct. Term, 1919 (March 1, 1920) [252 U. S. 85].

[2] 220 U. S. 373 (1911). While the court in this case had before it only the question of whether a covenant to maintain prices on resale could be enforced against third persons who took the chattel with notice of the covenant, the court based its denial of relief on the ground that the contract was illegal as in restraint of trade.

of the Sherman Anti-Trust Law.[3] The substance of the activity of the defendant in each instance was an attempt to establish a uniform price for resale by the dealers to whom it sold that product. In neither of the cases was it charged that the defendant had monopolized or attempted to monopolize any part of its industrial field. In each case the defendant manufactured 'branded,' or 'specialty,' goods.

In one of the two cases, *United States v. Colgate & Co.,*[4] the defendant accomplished this purpose by giving the dealers notice of the uniform prices to be charged for the goods, and informing them that in case of departure from the specified prices no more goods would be sold to them. To this policy the defendant vigorously and rigidly adhered, with the result—as the indictment charged—that a uniform price of resale was maintained. Upon a demurrer it was held that this indictment failed to charge any offense. In the case of *United States v. A. Schrader's Sons, Inc.,*[5] a similar maintainance of resale price was attained by means of contracts between the defendant and the dealers. The trial court sustained a demurrer to the indictment on the ground that the Dr. Miles case has been overruled by the Colgate decision. The trial court pointed out that, in its opinion, there was no real difference upon the facts between the cases, and said:[6] 'The only difference is that in the former (the Miles case) the arrangement for marketing its product was put in writing, whereas in the latter the wholesale and retail dealers observed the price fixed by the vendor. This is a distinction without a difference. The tacit acquiescence of the wholesalers and retailers in the prices thus fixed is the equivalent for all practical purposes of an express agreement.' This decision of the trial court was, however, reversed by the Supreme Court, Mr. Justice Holmes and Mr. Justice Brandeis dissenting, with Mr. Justice Clarke concurring only in the result.

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[3]Sherman Act of July 2, 1890, c. 647, Sec. 1; 26 Stat. at. L. 209: "Every contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor. . . ."

[4]*Supra*, note 1.

[5]*Ibid.*

[6]Opinion quoted on page 3 of Supreme Court's opinion.

In view of the opinion of the court below, and of the dissent, the Supreme Court seems almost cavalier in the statement: 'It seems unnecessary to dwell upon the obvious difference between the situation presented when a manufacturer merely indicates his wishes concerning prices and declines further dealings with all who fail to observe them, and one where he enters into agreements—whether express or implied from a course of dealing or other circumstances—with all customers throughout the different states which undertake to bind them to fixed resale prices.'[7] The business result of the two methods is the same, and if contracts to the end in question fall within the prohibition of the Sherman Law, it is to be remembered that that prohibition is not limited to 'contracts,' but extends to 'combinations' and 'conspiracies.' But the court even blurs the technical line which it draws between contract and no contract with its talk concerning agreements 'implied from a course of dealing or other circumstances.' What the decision of the court would be, for instance, in the case of an agreement by a manufacturer to give a rebate to the dealers who maintained his uniform prices, seems quite uncertain.[8]

The decision in the Miles case has been ably and, it is believed, deservedly criticized.[9] Practically all other courts in which the question had been raised had reached the contrary result.[10] Subsequent decisions in state courts have refused to follow it.[11] The undesirability, as a matter of economics, of the predatory price-cutting to which the decision gives rise, can

[7]Page 5 of the opinion.

[8]Such agreements were uniformly upheld before the decision in the Miles case. *In re Greene*, 52 Fed. 104 (1894). *Clarke v. Frank*, 17 Mo. App. 602 (1885); *Park & Sons v. Nat'l Wholesale Druggists Ass'n*, 175 N. Y. 1, 67 N. E. 136 (1903).

[9]See Kales, *Contracts and Combinations in Restraint of Trade* (Summary), Chap. IV. See also Charles L. Miller, *The Maintenance of Uniform Resale Prices*, 54 U. of Pa. L. Rev. 22.

[10]*Elliman Sons & Co. v. Carrington & Son*, L. R. 2 Ch. 275 (1901); *Grogan v. Chaffee*, 156 Cal. 611, 105 Pac. 745 (1909); *Garst v. Harris*, 177 Mass. 72, 58 N. E. 174 (1900); *New York Ice Co. v. Parker*, 21 How. Pr. (N. Y.) 302 (1861).

[11]*Ghirardelli Co. v. Hunsicker*, 164 Cal. 355, 128 Pac. 1041 (1912); *Fisher Flour Milling Co. v. Swanson*, 76 Wash. 649, 137 Pac. 144 (1913).

scarcely be denied.[12] Yet perhaps the case has become too firmly fixed as a principle of decision in the federal courts to make it desirable to overrule it at this late date and perhaps the remedy is now rather for the legislature.[13] But, even so, that is not a valid reason for introducing a new technical distinction into a field of judicially interpreted public policy which has already become stigmatized by an adherence to the letter rather than the spirit. Having decided the Colgate case as it was decided, it seems unfortunate that the Supreme Court did not go the full distance and overrule the Miles case. As the decisions stand, the Colgate case is an exception to an undesirable rule, and the existence of a bad rule has been prolonged altogether too often in the law by the multiplication of virtuous exceptions.''

§194. *MEACHAM v. JAMESTOWN, FRANKLIN AND CLEARFIELD RAILROAD CO.*

Court of Appeals of New York, 1914. [211 *N. Y.* 346.]

The contract contained the following provisions:

''In order to prevent all disputes and misunderstandings between them in relation to any of the stipulations contained in this agreement, or their performance by either of said parties, it is mutually understood and agreed that the said Chief Engineer shall be and hereby is made arbitrator to decide all matters in dispute arising or growing out of this contract between them, and the decision of said Chief Engineer on any point or matter touching this contract shall be final and conclusive between the parties hereto, and each and every of said parties hereby waives all right of action, suit or suits or other remedy in law or otherwise under this contract or arising out of the same to enforce any claim except as the same shall have been determined by said arbitrator.''

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[12]An enlightening account of this economic effect can be found in the hearings of the Stevens Bill (H. R. 13305) before the Committee on Interstate and Foreign Commerce in the House of Representatives, 63rd Congress, 2nd and 3rd Sessions (Feb. 27, 1914, to Jan. 9, 1915).

[13]See the opinion of Mr. Justice Brandeis in *Boston Store of Chicago v. American Graphophone Co.*, 246 U. S. 8, 27 (1918). [Cf. also, Montague, *Should the Manufacturer have the right to fix selling prices?* 63 An. of the Am. Acad. of Pol. Soc. Sci., 55. On the whole subject of Contracts in Restraint of Trade, see books with this title by Kales (Chicago, 1918), and Jolly (London, 1914, 2d ed.) EDRS.]

The trial justice before whom the issue was submitted determined as matter of law that submission to the arbitrator named in the contract, the chief engineer, and an award by him was and is a valid condition precedent to the plaintiff's right to sue.

CARDOZO, J.: An agreement that all differences arising under a contract shall be submitted to arbitration relates to the law of remedies, and the law that governs remedies is the law of the forum. In applying this rule, regard must be had not so much to the form of the agreement as to its substance. If an agreement that a foreign court shall have exclusive jurisdiction is to be condemned (*Benson v. Eastern B. & L. Assn.*, 174 N. Y. 83; *Nute v. H. M. Ins. Co.*, 6 Gray, 174, 180; *Slocum v. Western Assur. Co.*, 42 Fed. Rep. 235; *Gough v. Hamburg Am. Co.*, 158 Fed. Rep. 174), it is not saved by a declaration that resort to the foreign court shall be deemed a condition precedent to the accrual of a cause of action. A rule would not long survive if it were subject to be avoided by so facile a device. Such a contract, whatever form it may assume, affects in its operation the remedy alone. When resort is had to the foreign tribunal for the purpose of determining whether certain things do or do not constitute a breach, the cause of action must in the nature of things be complete before jurisdiction is invoked, and cannot be postponed by the declaration that it shall not be deemed to have matured until after judgment has been rendered. This must be so whether the tribunal is a court or a board of arbitrators. Indeed, the considerations adverse to the validity of the contract are more potent in the latter circumstances, for in the one case we yield to regular and duly organized agencies of the state and in the other to informal and in a sense irregular tribunals. (*Mittenthal v. Mascagni*, 183 Mass. 19, 23.) In each case, however, the fundamental purpose of the contract is the same: to submit the rights and wrongs of litigants to the arbitrament of foreign judges to the exclusion of our own. Whether such a contract is always invalid where the tribunal is a foreign court, we do not need to determine. There may conceivably be exceptional circumstances where resort to the courts of another state is so obviously convenient and reasonable as to justify our own courts in yielding to the agreement of the parties and declining jurisdiction. (*Mittenthal v. Mascagni, supra.*) If any exceptions to the general rule are to be admitted, we ought not to extend them to a contract where the exclusive jurisdiction has been bestowed, not on the regular courts of another sovereignty, but on private arbitrators. Whether the attempt to bring about this result takes the form of a condition precedent or a covenant, it is equally ineffective.

A very similar question was involved in *Benson v. Eastern Bldg. & L. Assn.* (174 N. Y. 83, 86). It was there argued that a provision requiring a trial in a certain county was intended, not as a limitation of the remedy, but as a condition precedent to a cause of action. CULLEN, J., writing for this court, disposed of the point in a few words:

"We think this argument proves too much. It is difficult to see why it would not uphold an agreement that all claims against the parties should be determined by arbitrators and not by the courts. It might be said with as much force in such a case as in the one now before us that the cause of action could, under the agreement, accrue only on the decision of the arbitrators. Yet nothing is better settled than that agreements of the character mentioned are void. (*Greason v. Keteltas,* 17 N. Y. 491; *Prest., etc., D. & H. Canal Co. v. Pennsylvania Coal Co.,* 50 N. Y. 250.) We think the doctrine of the *Nute Case* (6 Gray, 174) is the true one, that the stipulation affects the remedy, not the cause of action."

Building contracts are made in New York to be performed all over the United States. If the judgment of the court below is to stand, jurisdiction over controversies arising under such contracts may be withdrawn from our courts and the litigation remitted to arbitrators in distant states. The presence of the parties here, the ownership of property in this jurisdiction, these and other circumstances may make resort to our courts essential to the attainment of justice. If jurisdiction is to be ousted by contract, we must submit to the failure of justice that may result from these and like causes. It is true that some judges have expressed the belief that parties ought to be free to contract about such matters as they please. In this state the law has long been settled to the contrary. (*Sanford v. Commercial Travelers' Mut. Acc. Assn.,* 86 Hun, 380; 147 N. Y. 326; *Nat. Contracting Co. v. Hudson R. W. P. Co.,* 192 N. Y. 209. See also *Miles v. Schmidt,* 168 Mass. 339; *Fisher v. Merchants' Ins. Co.,* 95 Me. 486.) The jurisdiction of our courts is established by law, and it is not to be diminished, any more than it is to be increased, by the convention of the parties.

§195. *Arbitration Agreements.*—In the matter of arbitration agreements, two contradictory tendencies have manifested themselves in the attitude of courts. On the one hand, there is the notion expressed in this case that courts cannot be ousted from their jurisdiction by an agreement between parties. On the other hand, however, it is the settled practice where parties

have actually submitted to arbitration and the arbitrators have made an award, to enforce the award.

The legal rules affecting arbitration agreements may be summarized as follows: (1) specific performance of an agreement to appoint arbitrators will not be granted by a court of equity; (2) breach of a promise by the plaintiff to appoint an arbitrator, when the award of an arbitrator is not made an express condition precedent to a right of action, is no bar to an action on the contract; (3) breach of such a promise does not even give rise to an action for damages when the arbitration agreement is stated to embrace all possible future disputes about the contract, and even when the arbitration agreement is limited to questions of fact, only nominal damages will be given for a refusal to live up to it; (4) if the agreement specifies that arbitration shall be an express condition precedent to a right of action, the usual rules relating to express conditions are applied, provided the arbitration is to be limited to questions of fact, but the express condition is still generally held to be illegal and will therefore be disregarded whenever the arbitration clause is unlimited in scope; (5) up to the moment of an award, unless there be a statute similar to the so-called Walton Act recently passed in New York, either party may terminate the power of the arbitrator to make a binding award, although, of course, a withdrawal from the arbitration proceedings may subject the party making the revocation to an action for breach of contract; (6) a valid award once made, merges the original claim; (7) in some states statutes provide a complete system for the arbitration of differences before one or more arbitrators to be selected by the parties. The New York Code requires a written submission to arbitration, and permits the parties to stipulate that the award shall become the basis of a judgment of the court.

In recent years the practice of resorting to arbitration in business disputes has been increasing. Agreements for the arbitration of business disputes have been made between the United States Chamber of Commerce and the Chamber of Commerce of Buenos Aires. Many chambers of commerce and similar bodies are appointing standing committees on arbitration with lists of trade experts as available arbitrators. The forms of contracts

of the National Wholesale Grocers' Association and other trade associations have an arbitration clause incorporated therein. Largely as a result of the efforts of the National Association of Credit Men, statutes are being passed to provide machinery for making arbitration agreements effective, and courts of first instance in such cities as New York, Chicago, Cleveland, and Minneapolis are establishing, with or without statutory sanction, conciliation and arbitration procedure by which simple matters are expeditiously disposed of.

A serious objection to arbitration is that frequently it does not proceed upon the basis of principle. Too often its favorite rule is the so-called "rule of two," splitting the difference. That business men are frequently satisfied to resort to this haphazard means of settling their disputes is at least partly due to their dissatisfaction with the methods of courts, involving long delays and considerable uncertainty as to the final outcome. On the other hand, there are instances in which, just because of the absence of established principles, arbitration is a very useful instrument in business life. Such, for example, is the case of industrial disputes, in which each side is asking for a readjustment of terms, not on the basis of existing law, but rather on the basis of a set of conditions which is unique, and in which the question of power of control is frankly to be considered as an element. Questions of this kind can hardly be considered "judicial" in their nature.[1]

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[1] *Cf.* §246 end, *infra.*

CHAPTER VIII

THE OPERATION OF CONTRACTS IN BUSINESS AND THEIR INTERPRETATION IN THE COURTS

A. The Operation of Contracts in Business

§196. *From Arthur S. Corbin, Offer and Acceptance,* 26 *Yale Law Jour.* 169, 204.—"The rule generally laid down is that the acts of offer and acceptance must be expressions of assent. This has long been the theory upon which contractual obligations have been enforced. The test question usually put is, what was the intention of the parties? It must not be supposed from this, however, that no contractual relation can exist unless the parties both foresaw and intended it. If two parties have gone through the form of offering and accepting, the law determines the legal relations that follow. Frequently these come with surprise and shock to the parties themselves. It may be said here, as in the law of torts, that the parties are presumed to intend the consequences of their acts, but this is often a violent presumption contrary to fact. To indulge such a presumption is merely to hold that the actual intention of the parties is not the determinative fact, or even that it is wholly immaterial.

Parties are bound by the reasonable meaning of what they said and not by what they thought. If A makes an offer to B which B reasonably understands to have a particular meaning, and so accepts, A is bound in accordance with B's understanding. So also, if A's offer has only one reasonable meaning, B is bound in accordance therewith, even though he accepted supposing the meaning to be otherwise. The operative act creating an obligation is the *expression* of intention and not the thought process. It may be said that the purpose of the rule is to carry

out the intentions of the parties in the great majority of cases; but it seems better to say that its purpose is to secure the fulfilment of the promisee's reasonable expectations as induced by the promisor's act. In the law of contract as in the law of tort, men are expected to live up to the standard of the reasonably prudent man. If there is a misunderstanding and neither party was negligent, there is no contract. The same is true if both are equally negligent.

The legal relations consequent upon offer and acceptance are not wholly dependent, even upon the reasonable meaning of the words and acts of the parties. The law determines these relations in the light of subsequent circumstances, these often being totally unforeseen by the parties. In such cases it is sometimes said that the law will create that relation which the parties would have intended had they foreseen.[1] The fact is, however, that the decision will depend upon the notions of the court as to policy, welfare, justice, right and wrong, such notions often being inarticulate and subconscious.''[2]

§197. *From Nathan Isaacs, The Standardizing of Contracts,* 27 *Yale L. J.,* 34, 38.—The number of details in a contract actually foreseen by the parties, or made to depend upon a considera-

[1]"Supposing a contract to have been duly formed, what is its result? An obligation has been created between the contracting parties, by which rights are conferred upon the one and duties are imposed upon the other, partly stipulated for in the agreement, but partly also implied by law, which, as Bentham observes (Works III, 190) 'has thus in every country supplied the short-sightedness of individuals, by doing for them what they would have done for themselves, if their imagination had anticipated the march of nature.'" Holland, *Jurisprudence* (10th ed.), p. 278. In *Leonard v. Dyer* (1857), 26 Conn. 172, 178, the court said: "And if we were to add stipulations to the contract which the parties themselves did not make, it appears to us that such only should be inferred as the parties themselves would have made, had they foreseen the circumstances that rendered such stipulations important." See also Bankes, L. J., in *Grove v. Webb* (1916), 114 L. T. 1082, 1089.

[2]"You can always imply a condition in a contract. But why do you imply it? It is because of some belief as to the practice of the community or of a class, or because of some opinion as to policy, or, in short, because of some attitude of yours upon a matter not capable of exact quantitative measurement, and therefore not capable of founding exact logical conclusion." Justice Holmes, *The Path of the Law,* 10 Harv. L. Rev. 466.

tion of the peculiar conditions surrounding the particular contract in question, as compared with the number of details depending on some more or less standardized notion of a contract varies from time to time and in different classes of contracts. The situation in which the details are fully standardized is somewhat roughly and inaccurately referred to as "status." In this sense, quoting Sir Henry Maine, writers of the nineteenth century have constantly pointed out a gradual progression from status to contract in our law. On the other hand, it is clear that the tendency today is toward a greater degree of standardizing in contracts. There are many statutes which set out in detail standardized insurance policies, normal types of sales, and similar agreements, limitations upon contracts of employment and the like, sometimes with the stipulation "any contract to the contrary notwithstanding," though more often only "in the absence of a specific agreement to the contrary." In ordinary transactions, people cannot or will not stop to make special agreements "to the contrary." Therefore, they find themselves governed by the statute with its prescribed insurance policy, its prescribed bill of lading, warehouse receipt, stock-transfer, negotiable instrument, articles of partnership, its prescribed type of sale. When the question arises whether title has passed to a buyer, they will find the answer in the mechanical rules of the code for the ascertainment of their "intention," a constructive intention. The effect is a making of contracts in wholesale lots, just as we now make corporations in wholesale lots. A practical check on the individuality of contracts, if not a theoretical limitation on the freedom of contract, and a standardization of legal relations, are the net results.

§198. *Uniform Sales Act, Section* 1.

1. [*Contracts to sell and sales.*] (1) A contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for a consideration called the price.

(2) A sale of goods is an agreement whereby the seller transfers the property in goods to the buyer for a consideration called the price.

(3) A contract to sell or a sale may be absolute or conditional.

(4) There may be a contract to sell or a sale between one part owner and another.

§199. *Standardizing in the Uniform Sales Act.*—The Sales Act is in the main a basis for a standardized contract of sale. What is codified is largely the presumptions indulged in on the basis of the ordinary intention of parties when goods are sold or when their sale is contracted for in the regular course of business. Read in this light, it becomes far more intelligible and significant as a business document than as a legal document. Its success or failure as a piece of codification must be judged largely by the extent to which it summarizes the general understanding of business men. Likewise if an historical explanation is wanted for any of its provisions (that are not mere repetitions in a particularized form of the ordinary laws of contract) it is well to consider business practice as well as the reasoning of the courts. Thus the question of when title and the risk of loss pass, the question of whose duty it is to transport the goods and whose agent the carrier is and many others were worked out in business practice before they reached the courts. *Cf.* §227, *infra.* That even to determine the scope of the act resort must be had to the practice and understandings of business is illustrated in the following case:

§200 *FRIEND v. CHILDS DINING HALL CO.*

Supreme Judicial Court of Massachusetts, 1918. [231 *Mass.* 67.]

RUGG, C. J.: There was evidence tending to show that the defendant kept in Boston a restaurant, in which the plaintiff ordered from one of the waitresses, "New York baked beans and corned beef." This food was served to the plaintiff and she sat at a table to eat it. She testified, "I started to eat the food and there were two or three dark pieces which I thought were hard beans, that is, baked more than the others, and I put two in my mouth and bit down hard on them, and . . . I was hurt . . . I took those things out of my mouth and found they were stones." There was no further evidence that the plaintiff had anything to do with the selection of the beans. She gave no instructions respecting the food other than to order it.

There was no evidence of express warranty or that the defendant knew of the presence of the stones in the food. There was evidence of injury to the plaintiff. At the close of the evidence the plaintiff elected to rely upon a count for breach of an implied warranty of fitness to eat in a contract for food to be eaten on the premises of the defendant. The defendant introduced no evidence. The question is whether the plaintiff was entitled to go to the jury.

There is strong ground for holding that the contract made between one who keeps a restaurant and one who resorts there for food to be served and eaten on the premises is a sale of food. The evidence in *Commonwealth v. Worcester,* 126 Mass. 256, was that on two or three different occasions people resorted to the defendant's dwelling house and there were served with meals; with these and as a part thereof intoxicating liquors were provided. The price paid was single, including both food and drink. The complaint was for keeping a tenement used for the illegal sale and illegal keeping for sale of intoxicating liquors. It was held that "The purchase of a meal includes all the articles that go to make up the meal. It is wholly immaterial that no specific price is attached to those articles separately. If the meal included intoxicating liquors, the purchase of the meal would be a purchase of the liquors. It would be immaterial that other articles were included in the purchase, and all were charged in one collective price." That decision rests entirely upon common law principles as to sales and St. 1875, c. 99, §17, then in force (now R. L. c. 100, §64), making delivery of intoxicating liquor under certain circumstances *prima facie* evidence of sale, was not adverted to and very likely was not applicable to the facts there presented. Precisely the same point was held in *State v. Lotti,* 72 Vt. 115. The defendant in *Commonwealth v. Warren,* 160 Mass. 533, was charged with selling milk not of good standard quality contrary to St. 1886, c. 318, §2. The evidence was that a guest at the inn of the defendant conducted on the American plan was served as a part of his breakfast, for which he paid a single price, with a glass of milk not of the quality required by the statute. It was said in the course of the opinion holding that the defendant might be found guilty, "The milk bought by the witness Kelly was purchased by and delivered to him as a part of his breakfast, and was just as much a sale as if a specific price had been put upon it, or it had been bought and paid for by itself." Similar decisions have been made by other courts. In *People v. Clair,* 221 N. Y. 108, it was held that the serving of partridges by a hotelkeeper to guests who paid for board and room at the rate of $2 per day,

was a sale as matter of law in violation of a statute which provided that such game should "not be sold, offered for sale, or possessed for sale for food purposes." A similar decision was rendered in *Commonwealth v. Phoenix Hotel Co.*, 157 Ky. 180, with reference to the possession of quail by an innkeeper with intent to serve to his guests in violation of a statute which prohibited the sale of such birds. It there was said at page 185, "The guest at the hotel or restaurant who is served with quail for compensation as certainly purchases it and the proprietor of the hotel or restaurant as certainly exposes it for sale and sells it as if it were purchased for compensation from a dealer who had it for sale and was carried home by the purchaser to be served on his table." It was decided in *Commonwealth v. Miller,* 131 Penn. St. 118, that where the keeper of a restaurant served oleomargarine with a meal to a guest who was charged and paid fifty cents for the meal, there was a sale within the terms of a statute which prohibited the sale of oleomargarine.

In view of these decisions it would be difficult for this court to hold that the transaction arising from a contract to serve to a guest food to be eaten by him upon the premises of the keeper of an eating house, is not a sale. If it is a sale, then plainly it is governed by the sales act, St. 1908, c. 237, §15 (1), which is in these words: "Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, and it appears that the buyer relies on the seller's skill or judgment, whether he be the grower or manufacturer or not, there is an implied warranty that the goods shall be reasonably fit for such purpose." It is manifest that at least it might be inferred from the relations of the parties, that the guest who asks to be served food upon the premises of one who is the keeper of a restaurant makes known as the particular purpose for which the food is required that it is then and there to be eaten, and that he relies upon the latter's skill or judgment in the selection and preparation of the food. Hence there would be an implied warranty that it was reasonably fit for such purpose.

If the transaction is a sale, the rule is the same apart from the sales act. That was settled after great consideration in *Farrell v. Manhattan Market Co.*, 198 Mass. 271, a case decided before the sales act took effect. It there was held, page 284, that the English rule as to implied condition of soundness in the sale of food by a dealer prevails here. That rule was stated at pages 280, 281, in these words: "The rule now established in England is that, in the sale of an article of food by one not a dealer, there is no implied condition or warranty that it is fit to be eaten.

. . . Since the sale of goods act, if the sale is made by one not a dealer, there is no liability, by force of §14. If the sale is by a dealer and the selection of the food is left to him, it is an implied term or condition of the sale that the provisions sold shall be fit for food whether supplied under a pre-existing contract, . . . or in response to an order not given in person, . . . or even when the order is given in person in the dealer's shop, provided, . . . that the selection is left to the dealer."

But there is authority to the effect that, when food is furnished to a guest by the keeper of a restaurant or inn, the transaction does not constitute a sale, that the title to the food does not pass, that the customer may consume so much as he pleases, but that he cannot carry away of the portion ordered that which he does not eat, or give or sell it to another; and that the charge made is not for the food alone, but includes the service rendered and the providing of a place in which to eat. It is stated in Beale on *Innkeepers,* §169, "The title to food never passes as a result of an ordinary transaction of supplying food to a guest; or, as it was quaintly put in an old case, 'he does not sell but utters his provision.' " *Parker v. Flint,* 12 Mod. 254. [The court then examines the history of the liability of innkeepers for serving deleterious foods.]

On principle and on authority it seems to us that the liability of the proprietor of an eating house to his guest for serving bad food rests on an implied term of the contract and does not sound exclusively in tort, although of course he may be held for negligence if that is proved. Without repeating the reasoning of *Farrel v. Manhattan Market Co.,* 198 Mass. 271, we are of opinion that, on sound legal principles, it bears with equal force upon the facts here presented. Even if there were no common law authority (which there is, as already pointed out), it would not be practicable to establish a distinction upon this point which could be supported in reason, between the liability of a retail dealer in meat for immediate consumption and of a victualler who serves food to guests to be eaten forthwith at his own table. Every argument which supports liability of the former tends to sustain liability of the latter with at least equal cogency. They appear to us to rest upon the same footing in principle. . . .

Our conclusion is that, whether the transaction established on the evidence between the plaintiff and the defendant be treated as a sale of food, or as a contract for entertainment where the defendant simply "utters his provision" (to use the neat phrase of *Parker v. Flint,* 12 Mod. 254, employed more than

two centuries ago) for the benefit of the plaintiff, there was a case to be submitted to the jury.[1]

§201. *The Subject Matter of Contracts, as Classified in Law and in Business.*—Modern business thought tends to deal with all "commodities" offered by business men in the general category of things sold. We talk of selling not only personal property or goods, but also real estate, services, privileges. We talk of the "labor market," the "money market," of "selling advertising" and "selling insurance," and even of "selling ideas." In non-competitive businesses the idea of salesmanship has not impressed itself on the popular vocabulary to the same extent; for example, we do not think of the sale of the service of transportation; yet the same principle is involved in the sale of tickets and on the other side when we speak of buying so much space in a ship or in a freight car.

Whether this way of dealing with "commodities" is sound or not, two propositions concern us here: first, that it is decidedly not the point of view of the common law; second, that the business point of view is gradually transforming that of the law. Consequently we must not only indicate the types of commodities for which the law has historically provided peculiar types of contracts, but we must consider the reasons, historical and analytical, for the making and continuation or discontinuance of these distinctions.

The first great distinction is between personal property and real estate. The Uniform Sales Act does not apply to the latter.

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[1]With this case should be contrasted the case of *Ash v. Childs Dining Hall Co.* (1918), immediately following it, 231 Mass. 86, where suit was brought by damages caused by a tack swallowed in blueberry pie. The plaintiff rested her case neither on the law of sale nor on the duties of a proprietor of an eating house, but purely on the theory of negligence. As the mere presence of the tack did not prove negligence (it was held not a case of *res ipsa loquitur*) in the absence of actual proof of negligence the plaintiff could not recover. *Cf.* §246, *infra.* The business man will certainly not be impressed favorably with a legal procedure which denies plaintiff a recovery merely because he failed to prove an unnecessary allegation, although he had both alleged and proved sufficient facts to constitute a cause of action. See note in 32 Harv. Law R. 71. On the implied warranties as to fitness of food offered, see Rollin M. Perkins, *Unwholesome Food as a Source of Liability*, 5 Iowa Law Bulletin, 6, 86 (1919-20).

Consisting as it does only of interests in land (and strictly only of life interests and interests of inheritance and not estates for years) its subject-matter cannot be moved from state to state, and hence the need of a uniform law that manifested itself in connection with movable goods did not exist, at least not to the same extent in the case of real estate. It must be remembered, too, that while the law of sales was developing in England real estate was not an ordinary commodity of commerce. Indeed, it can hardly be considered such today even in America. Accordingly no implied warranties are to be read into a contract for the sale of real estate; no title will pass by the mere intent of the parties without the performance of the acts required by law for the passing of title (under modern law the delivery of a "deed" or the taking effect of a will) though equity intervenes with a doctrine of "equitable conversion" that makes the risk of loss pass when title ought to be accepted; and because of the "uniqueness" of every piece of land as compared with ordinary merchantable wares, equity will grant specific performance of contracts for the sale of real estate. The interests that one may own in land are highly standardized: the most important are the fee simple, the largest interest known to the law, being virtually ownership for one's self and his heirs forever, with practically unlimited power of alienation; the fee tail, an estate of inheritance, with theoretically no power to cut off one's heirs, but practically with only slight and constantly lessening restrictions in this regard; the estate for life, that is so long as the holder of the estate or some other designated person lives; estates for years, including any definite period; estates from year to year; estates terminable at will. Only the estates for life and estates of inheritance are strictly real property, the other interests being chattels real and governed in most particulars by the laws of personal property. When land is given out for life or for a period of years, unless there is a provision that after the expiration of the particular estate it shall "remain" out for some one else, it automatically "reverts" to its former owner or his heirs. It is, of course, not customary to deal with a movable thing in this way by carving out interests in it instead of selling it out and out. Yet through special contracts or by provisions

in wills, sometimes aided by statutes or equitable doctrines, very similar results can be attained in dealing with movables. From a commercial point of view, however, such limited interests in things are by no means an ordinary commodity. Hence the sale of interests in personal property are for practical purposes sales of "goods," that is, of the complete set of rights recognized by law in the things themselves and not of "estates." Among other striking differences between the two types of property, real and personal (the latter class including besides movable things, all interests in lands not classified above as real property), are the following: at the death of the owner real estate "descends" to the heirs directly or to devisees designated by will, whereas personal property must be administered and used to pay the debts of the decedent to the exoneration, if possible, of the real estate, and the surplus is "distributed" to the "next of kin" or the legatees named in the will; surviving spouses have certain interests (dower and courtesy) which in many states cannot be cut off even by the sale of real property during the life-time of the owner without a release from the husband or wife; claims to real estate adverse or superior to or concurrent with those of the apparent owner or possessor are not so readily defeated in the interest of the freedom of circulation of goods demanded by commerce as similar claims are in the case of personal property. Thus in England and in most of the American jurisdictions the period during which land must be openly, notoriously and adversely held to defeat a title under the Statute of Limitations is twenty-one years as compared with four or six years for chattels. In the case of chattels English law permitted a complete break in the chain of title in the case of goods bought in "market overt" even if the goods had been stolen from the original owner. In this country the doctrine of market overt is not held, but the tendency to mitigate in the interest of commerce the doctrine that one can sell no better title than he owns is illustrated even in the case of real property in our registration laws and to a much greater extent in the case of personal property. Registration laws are an outgrowth of the need of facilitating the examination of titles for commercial purposes. So far as they make unrecorded claims of no effect (the statutes differ in that some

do and others do not save the unrecorded claim where there is actual or constructive notice[1]) these statutes surrender the ideal of a chain of title in the interest of security and definiteness of business transactions. The modern scheme of recording not only documents of title but judicial or quasi-judicial ascertainments of the condition of a title to the exclusion of all claims that have not been properly put forward and allowed at a stated time (the Torrens system and its modifications) carries the idea of making real estate a marketable commodity as far as it can go without abolishing the traditional distinctions between real estate and personal property altogether. The theory of recording acts has been extended, in the form of filing provisions, to personal property, but generally conceding a greater effect to possession than is conceded in the case of realty. Thus Section 9 of the Uniform Conditional Sales Act provides:

> Where goods are delivered under a conditional sale contract and the seller expressly or impliedly consents that the buyer may resell them prior to performance of the condition, the reservation of property shall be void against purchasers from the buyer for value in the ordinary course of business, and as to them the buyer shall be deemed the owner of the goods, even though the contract or a copy thereof shall be filed according to the provisions of this act.

Compare also as to the effect of possession in chattel mortgages, *Francisco v. Ryan*, §292, *infra* and notes. In the case of real estate security of title is still balanced against the business interest of security of ordinary transactions, although many of the historical reasons for dealing with real estate separately, going back to the feudal system in which land-tenure was closely associated with political position and coming down through English history in which land-tenure was persistently connected with social position, have disappeared.

The influence of business concepts in dealing with land is nowhere more evident than in the manner in which leases, which were formerly thought of as grants, have come to be considered

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[1]Such questions of priority are of importance to the business man taking a lease on premises already mortgaged or likely to be mortgaged.

simply formal contracts. The parties rather freely insert such clauses as they see fit, and the courts when called upon to interpret the terms of a lease seek to give effect to the intention of the parties. "The very words ['landlord and tenant'] stand as a monument to the feudal origin [of this relation]. Today we speak, properly, of ['lessor and lessee.'] From a relation that once determined a man's social and political standing, a relation that assigned to him a court within which to seek protection for his rights, a relation that shaped his obligations of patriotism and loyalty, it has degenerated or developed into a purely contractual relation, differing from the most ordinary commercial relation only in one or two anomalous particulars."[2]

[2]Isaacs, *The Merchant and His Law*, 23 Journal of Political Economy, 542. Among the peculiarities of the relation are the inability of the tenant to attack the landlord's title, the doctrine that in the absence of statute or special contract, destruction of buildings will not excuse the payment of rent, that a rent accrues on a certain day and is therefore not apportionable as to time, that covenants as to rent run with the land. Even before business ideas made any appreciable impression on the body of the law of real property, they succeeded in abstracting from its sphere control over certain things annexed to the soil. In commenting on "the relaxation of the stringent old rule that whatever was annexed to the soil became parcel of the soil and subject accordingly to the same ownership as the soil," Mr. Strahan, in his *Law of Property* (4th ed., 1905, p. 91), says: "England was always a commercial nation in which the merchant class held great power. Accordingly, as might be expected, the first relaxation of the rule was with regard to trade fixtures (*Lawton v. Lawton*, 3 Atk. 13). Now, when a house is let expressly for the purpose of carrying on a trade, all trade machinery affixed by the tenant remains his property, unless it is expressly covenanted in the lease that it shall belong to the landlord. [Per Vaughan Williams, L. J., in *Lambourn v. McLellan* (1903), 2 Ch. 268, 277.] Then during the eighteenth and nineteenth centuries the middle classes acquired much wealth and with it the power which wealth brings. The middle classes were those who most frequently became the lessees of houses, and who spent money in adding fixtures to such houses for, in the words of Martin, B. (in *Elliott v. Bishop*, 10 Ex. 496, 507), the more convenient or luxurious occupation of them,' and naturally it was with respect to them that the next relaxation of the rule took place (*Grymes v. Boweren*, 6 Bingh. 437). But it is to be observed that Martin, B., says nothing about fixtures for agricultural purposes being saved to the tenant." Mr. Strahan then goes on to discuss interestingly, but a little too unqualifiedly, the manner in which the "predominant influence, social and political," controlled the development of the law of fixtures. That the relaxation of the old rule proceeded faster in America, but under similar influences, is nicely illustrated in *Van Ness v. Pacard* (1829), 2 Peters 137, 147, where Judge Story held a house with a shop in it a "trade fixture" on land in the city of Washington, in order to preserve the interest of the tenant.

What has been said of the commercializing of the relations growing out of real estate transactions, applies *mutatis mutandis* to other relations of importance in the business world, notably that of employer and employee. The evolution of this relation from a domestic one into a contractual one, and the limits upon the contractual theory are traced in some detail in Part IV of this book. (See §§341, 349 ff.) The manner in which mercantile usage led the way in making intangible assets, such as choses in action, assignable, is suggested in the history of negotiable instruments (see §§318, 319, 320, 321, 335); and the limits that the law still imposes on the free transfer of certain intangible assets, which the business world is prepared to accord a fuller recognition, are illustrated in the discussion of goodwill (see §28, *supra*). Patent-rights, though intangible, have been so thoroughly assimilated to property, that they are freely assignable. The salability of various types of part-interests in goods is recognized in the Uniform Sales Act: thus one may sell (and not merely contract to sell) undivided shares in goods and even specific quantities from a larger mass of fungible goods, that is, goods any portion of which may be substituted for any other. In the case of partnership goods, though title may be passed by a partner to such interest as he may have in partnership property, it must be remembered that he cannot, without the consent of the other partners, substitute another to his place in the partnership, that therefore no direct power of control over partnership assets passes, and what is virtually sold is only a right to participate in the surplus, if any, upon the dissolution of the partnership and the payment of its debts.

As to future goods and expectancies, strictly speaking a sale is impossible. Yet within limits an attempted sale will be interpreted as a contract to sell, which will ripen into a sale. In the case of expectancies there is danger that the transaction may be a mere speculation or betting on the future, which would be contrary to public policy; hence somewhat arbitrary lines have been drawn between reasonably assured expectancies, such as the income from existing contracts or the crop already planted, and more remote expectancies, the former being held proper subject matter for a contract of assignment or sale. Certain incomes,

such as salaries of public officers and pensions, are generally held incapable of being anticipated in this way for reasons of public policy. Contracts to sell future goods must be carefully distinguished from contracts to furnish work and materials. The distinction is sometimes important under the Statute of Frauds: thus an agreement to deliver at a future date an automobile or a carriage of a stock type, would, if the price were sufficient, require writing, whereas a similar agreement to furnish a special type, made to order, would not. (*Goddard v. Binney*, 1874, 115 Mass. 450.) *Cf.* Uniform Sales Act, Sec. 4.

A similar question as to whether the terms of the Sales Act apply to a transaction resembling a sale, namely, the furnishing of food and entertainment, is discussed *obiter* in the preceding section.

The furnishing of certain services of a wide public interest, such as those of the carrier of goods and passengers, banks, insurance companies, telephone and telegraph companies, is, as indicated in §35, *supra,* subject to public regulation, as well as to certain inherited limitations upon the freedom of contract, discussed in §§52 and 52a, *supra.* The object, in the main, of these regulations is to insure to the public fair treatment in the matter of service and prices, and security against loss from mismanagement or insolvency. In other respects the contracts made with reference to these services have become subject to the ordinary laws of commercial contracts, though each business has its own usages and customs, similar in scope to those discussed in the following sections.

The numerous contracts involved in safeguarding and facilitating credit operations are treated with greater particularity (§§270-340, *infra*) as are those involved in the various plans of business organization (§§341-431, *infra*).

§202. *From John Cassan Wait, Engineering and Architectural Jurisprudence* (1898), p. 531—" . . . Usages and customs are especially annoying to young and inexperienced engineers and architects, who read a contract and its accompanying specifications in the light and understanding of their schoolbooks or of the popular meaning of the terms employed; whose

understanding of the words 'cord' or 'perch,' etc., is that number of cubic feet given by their arithmetics or described by the lady teachers of their childhood. An experienced engineer would read between the lines, 'as it were,' and a 'cord' to him would mean several things—either a load of given weight or 100 or 128 cubic feet. Novices may marvel at interpretations given to terms of contract by trades, sometimes in plain contradiction to the usual meaning of the words employed, but the meaning adopted by the trade or business which employ them, will be the meaning given to them by the courts.

If accidents occur or injuries result from negligence or delay, the liability for such injury is often a matter of custom or usage. The liability of one party as against another for patterns, molds, or requisite appliances to prosecute or complete the work is sometimes a question of custom, as is also the meaning of words, terms, and phrases, and therefore the proper performance and completion of a contract or the skillful execution of a piece of work.

It may seem strange that it can be successfully maintained that a perch in a contract means 25 cubic feet, or that 1000 must be taken to mean 100 dozen, or 1200; or that black means white, or that a contract to pay for brick per 1000 means to pay for brick never laid or furnished; yet these are instances of the effect of usage on the interpretation of contracts.

All trades and businesses have trade usages and trade customs which may differ, even for different localities in the same trade, and since courts recognize them and employ them to construe the meaning of contracts, it is essential to know: (1) What constitutes a usage of custom; (2) when they may be employed to explain the meaning of contracts; (3) how may they be shown or proved; (4) usage of what place controls; (5) instances and terms defined. . . .''

§203. *Business Customs and Law.*—So far as usage and custom control in the interpretation of terms in an agreement very much as law does, the lawyer must be guided in his judgment by his business client. It is true, of course, as Lord Mansfield says, that if a point of law is ''once solemnly settled, no par-

ticular usage shall be admitted to weigh against it; this would send everything to sea again."[1] Nevertheless, Lord Mansfield's greatest accomplishment consists in the very act of transforming trade customs into legally recognized rules and principles. No sharp line can be drawn between the customs of a trade and its law, though it is true that the road through which a custom gets into the law is more likely to be legislation than adjudication today.

§204 *PENNELL v. DELTA TRANSPORTATION CO.*

Supreme Court of Michigan, 1892. [94 *Michigan* 247.]

LONG, J.: This action was commenced in justice's court, and after a trial there appealed to the circuit, where, upon the trial before a jury, plaintiff had verdict and judgment for $29.78.

It appears that the plaintiff entered into a verbal contract with the defendant through defendant's agent, Capt. Field, who was in the employ of defendant as captain of a boat running on what is known as the "Inland Route," through Cheboygan county, by the terms of which the plaintiff was to clean out Crooked river from snags, logs, stumps, etc., that obstructed the channel. He was to be allowed two dollars per day, and the same for all help which he might employ. He hired two men, and entered upon the work the next day. Upon the completion of the work, plaintiff was paid the two dollars per day for himself and each man, as the contract stipulated. He then presented a bill for board of himself and men during the time employed. It is conceded that nothing was said about the board of himself and men at the time the contract was entered into, but on trial the court permitted the plaintiff to give evidence of a custom or usage in that community to pay the board of men employed in certain kinds of business. This evidence was admitted under objection of defendant's counsel. It was shown by several witnesses for the plaintiff that a custom existed among lumbermen in that vicinity to pay the board of the men who were engaged in running logs down the streams, and cleaning out streams for the purpose of running logs. It was also shown that Capt. Field, defendant's agent, had resided in that vicinity for five years and upwards. Capt. Field was called as

[1]*Edie and Laird v. The East India Company* (1761), 1 Wm. Blackstone 295. A discussion of the conditions necessary to make usage binding upon parties may be found in Morse on *Banks and Banking,* 4th ed., Sec. 9.

a witness by defendant, and asked if he knew of any such custom. The answer was objected to by plaintiff's counsel as incompetent, and it was ruled out by the court. . . .

The court charged further: "The custom must be general, and it must be uniform. It must not vary from time to time. It must be an established custom; that is to say, a custom which would spring up at the time this contract was made, and continue from that time to the present, would not be an established custom. This must be the custom of that vicinity; it must be general, universal." Continuing, the court said: "Now, if you find that such a custom existed, and that this contract was made in relation to such custom, or that it was so well established and universal that all persons in that vicinity would be supposed to know the custom, and make their contracts in relation to it, then you will bring in a verdict for the plaintiff."

We think the court was in error in refusing to permit the defendant's agent to testify that he had no knowledge of such a custom; and that the court was also in error in refusing to give the defendant's second, third, and fourth requests to charge, as well as in the charge as given. Where the custom or usage is restricted to a certain locality, or business, though it has become general and uniform in that locality or in that particular business, and the custom is relied upon as a ground of recovery, it is settled, we think, that such custom is not conclusive on the party, so that he may not give evidence that it was unknown to him. . . .

In cases where evidence of usage is admissible at all, it is only on the ground that the parties who made the contract are both cognizant of the usage, and must be presumed to have made their engagements in reference to it. *Van Hoesen v. Cameron,* 54 Mich. 614. The decisions in this state are uniform that custom cannot change a definite contract, and that no custom is binding which is not certain, definite, uniform, and notorious. *Lamb v. Henderson,* 63 Mich. 305, and the cases there cited. In the above case it was said by Chief Justice Campbell: "No attempt was made to bring notice of this usage to the knowledge of plaintiff." The defendant in that case sought to set up a custom to defeat the payment of certain traveling expenses to one of his salesmen during the time he spent at the home office.

The court in the trial of the present case should not only have allowed Capt. Field to answer the question, and given the requests to charge asked, but should have also instructed the jury that the plaintiff could not recover unless they found that the parties contracted in reference to this custom; and in determining the question they should consider the testimony of

defendant's agent, who made the contract. *Higgins v. Moore,* 34 N. Y. 425.

Judgment must be reversed, with costs, and a new trial ordered. The other Justices concurred.

§205 *HAYDEN v. FREDERICKSON.*

Supreme Court of Nebraska, 1898. [55 *Nebr.* 156.]

SULLIVAN, J.: By this proceeding in error Hayden Bros. seek to reverse a judgment rendered against them by the district court of Douglas county in an action based on the following contract:

> "This is to bear witness that Nicholas Frederickson has this day sold and delivered to Hayden Bros. a stock of linens, flannels, domestics, blankets, quilts, and all patterns that are staple and down to date, and everything belonging to the linen and domestic department of the Bell Department Store, of Omaha, Nebraska. It is hereby agreed and understood that said Hayden Bros. pay to said Nicholas Frederickson therfor cash at the completion of the inventory, at the rate of ninety (90) per cent. of the original contract price of said goods, without discount. And it is further agreed that said Hayden Bros. pay to Nicholas Frederickson the sum of $250 to bind the bargain at the signing of this agreement.
>
> "Witness our hands this 16th day of September, 1893.
>
> "Nicholas Frederickson.
> "Hayden Bros."

The verdict in favor of the plaintiff was returned in response to a peremptory direction of the trial court. The controversy results from the refusal of the defendants to accept and pay for the patterns mentioned in the contract. This refusal they attempted to justify at the trial on the ground that the patterns were not "staple and down to date." In making the invoice and ascertaining the patterns that answered the requirements of the contract the plaintiff used an album issued for the then current year by the manufacturer of the patterns. The contention now is that this album was the exclusive criterion by which to determine whether the patterns were "staple and down to date." The trial judge, it is quite evident, took this view of the matter, for he excluded the testimony of competent witnesses offered by the defendants for the purpose of showing that the patterns were not staple on account of the condition of the sealed envelopes in which they were contained and in which they would be kept

until sold in the usual course of the retail trade. He also excluded evidence tending to prove that patterns are bought and sold exclusively upon the conditions of, and representations on, the envelopes in which they are inclosed, and that patterns contained in soiled, torn, or shop-worn envelopes are not considered, in that line of business, as salable and up to date. The refusal to receive and submit the proffered evidence to the jury was error, for which the judgment of the district court must be reversed. When the contract in question was made the defendants did not agree to accept the "Album of Fashions of the Universal Fashion Company" as an infallible standard by which to determine what patterns were staple and up to date; and there is no evidence whatever in the record to warrant the assumption that it was accepted and recognized as such standard among merchants dealing in articles of this kind. On the contrary, it is shown that the fashions are constantly changing and that staple and unstaple patterns may be found on the same page of any fashion book. In the absence of any law, agreement, or binding usage among merchants, fixing an exclusive test by which to determine the question in dispute, the evidence of witnesses qualified by experience to speak on the subject is competent and should be received.

The court also erred in refusing to submit the case to the jury on the evidence admitted without objection. The testimony of Mr. Johnson, a witness for the defendants, was to the effect that he saw and examined the patterns; that they were all old styles and were neither merchantable nor up to date, some of them having hoopskirts and bustles. He also stated that Frederickson admitted to him that they had been purchased more than two years before the sale to Hayden Bros. This was clearly sufficient to raise an issue of fact for the decision of the jury, but it is probable the court considered it incompetent, as it was of the same character as the evidence excluded. For these errors the judgment of the district court is reversed and the cause remanded for further proceedings.

Reversed.

§206. *Expert Testimony on Customs and Usages.*—Opinion evidence is generally not admissible in court, except upon proof that the witness is an expert. There are some matters upon which, in a sense, the average man is an expert. As to business customs, men with experience are experts, and it is astonishing what a variety of experts courts become acquainted with. In the above case, the testimony offered with reference to fash-

ions, and such technical matters as "hoop skirts and bustles," should, according to the court, have been submitted to the jury.

§207 *BROWN v. COLE et al.*

Supreme Court of Iowa, 1877. [45 *Iowa* 601.]

SEEVERS, J.: Counsel for appellant state the questions for determination to be as follows: "Aside from the question of defective and irregular verdict of the jury, it seems that all other questions in this case are merged in these two, to wit: Does the method pointed out by the contract for ascertaining the number of brick mean no more than, and nothing different from, the rule known as 'masons' measurement;' and, shall the openings in the wall, under the reading of the contract, be considered filled with brick in arriving at the number of brick delivered by defendants." The question, then, is how, under the terms of the contract, are the brick to be counted. We are unable to see any ambiguity in the contract, either latent or patent, and the contract itself provides the rule for "counting and enumerating" the brick. If the contract had provided for the delivery of one hundred thousand brick, and there stopped, we suppose the plaintiff would have been entitled to that number of brick by actual count, but the brick were to be "counted and enumerated in the wall according to the custom and rule of bricklayers in ascertaining the number of brick in a solid wall, not allowing anything for space occupied by openings in wall." This, then, is the way the parties have determined the brick shall be counted. It is true that the rule adopted by bricklayers is at best but an arbitrary estimate, and it is not pretended that the actual number of brick in the wall is thereby ascertained. This, however, is immaterial, because the parties have stipulated the count shall be made in accordance with that rule. It must be evident that an actual count of the brick was not intended, for the contract contemplates a counting "in a solid wall." Now, it is simply impossible to count and ascertain how many brick are in a solid wall more than one brick in thickness. The wall was to be solid, and no allowance made for openings. The Circuit Court having construed the contract in accord with the foregoing view, it follows no error was committed in so doing. . . . Affirmed.

§208 *PITTSBURGH v. O'NEILL.*

Supreme Court of Pennsylvania, 1845. [1 *Pa. St.* 342.]

PER CURIAM. All trades have their usages; and when a

contract is made with a man about the business of his craft, it is framed on the basis of its usage, which becomes part of it, except when its place is occupied by particular stipulations. Now the witness had been a paver for thirty years; and he was called, as an expert, to speak of the method employed by pavers to ascertain the number of bricks laid in a job without reckoning them by tale. He was allowed to prove how many of an ordinary size went to the square yard; and from that the whole number could be ascertained by measuring the sides of the pavement, just as the whole number of shot in a pile can be ascertained by the number contained in the sides of the base. As an expert, therefore, the witness was competent. But it is said that the paving of the top of the basin was to be done on the terms contained in the written contract for paving the bottom and the sides. That contract, however, has no provision that would affect the general principle; and the evidence was consequently proper.

Judgment affirmed.

§209. *GOODNOW v. PARSONS.*

Supreme Court of Vermont, 1863. [36 *Vt.* 46.]

KELLOGG, J.: . . . The report does not show that there was any express agreement between the parties in respect to the rule of computing interest upon their respective accounts, or that the defendant had any knowledge of the plaintiff's custom or course of dealing in computing interest on his accounts. The plaintiff's claim to interest computed on the monthly balances of his account must stand either on the express contract of the parties, or on a contract implied from their course of previous dealing, or from the other special circumstances of the case. It is settled in this State that in cases of ordinary running accounts on book, not controlled as to interest by a different contract, express or implied, the rule of computing interest is to make annual rests and to allow interest thereafter on the balance in favor of the party to whom it may be due. A person dealing with another has a right to rely upon the application of this rule on the settlement of his account, unless the circumstances of the case are such as to affect him with notice or knowledge of the usage, custom, or claim of his creditor to compute interest by making rests at shorter periods than one year; and the defendant's dealings with the plaintiff must be taken to have been had with the expectation that they would be adjusted according to the settled rule and custom, unless it is made to appear that he had information that the plaintiff would insist upon a different rule. There is nothing in the referee's report which will

warrant the inference that the defendant knew anything about the plaintiff's practice or custom in respect to casting interest on his accounts; and the report does not show any special circumstances from which a contract on the part of the defendant to pay interest according to the rule insisted on by the plaintiff and adopted by the referee can be inferred. The plaintiff's practice or custom in this respect would not take the case out of the operation of the ordinary rule, or become binding upon the defendant, until the defendant was informed of it, and would then be applicable only to the subsequent dealings between them. These views are fully supported by the cases of *Langdon v. Town of Castleton,* 30 Vt. 285; *Birchard v. Estate of Knapp,* 31 Vt. 679; and *Wood v. Smith,* 23 Vt. 706; and, as the referee's report does not show any such facts as would warrant the computation and allowance of interest on the monthly balances of the plaintiff's account, the judgment of the county court allowing the plaintiff to recover interest so computed is reversed, and judgment is to be rendered in favor of the plaintiff for the balance in his favor on the claims allowed by the referee to the parties respectively as stated in the report, with interest on the yearly balances of account according to the ordinary rule, instead of interest on the monthly balances as computed by the auditor.

§210. *J. H. Balfour Browne, The Law of Usages and Customs,* p. 48 (*Clarke's Am. ed.,* p. 93).—"There are scarcely any questions which come before courts of law so difficult of decision as those involving customs. Here the Court has to deal with something which is vague and indefinite, which bears much similarity to law, but which yet comes before them, in the guise of evidence, which is not definitely written in books, but lives only in the breath of the public and the vague traditions of the actions of men. It requires not only legal learning but genius to deal with such cases, and it is not to be wondered at if many of the common law judges shrink from the task of exercising such an indefinite jurisdiction. Lord Campbell, with great sagacity, has pointed out this fact. 'Lawyers,' he says, 'desire certainty, and would have a contract express all its terms, and desire that no parol evidence beyond it should be receivable. But merchants and traders with a multiplicity of transactions pressing on them, and moving in a narrow circle and meeting each other, desire to write little and leave unwritten what they

may take for granted in every contract. In spite of the lamentations of judges they will continue to do so, and in a vast majority of cases of which courts of law hear nothing they do so without loss or inconvenience, and upon the whole they find this mode of dealing advantageous even at the risk of occasional litigation.' "[1]

§211 *THE SCHOONER REESIDE.*

United States Circuit Court, 1837. [2 *Sumn.* 567.]

STORY, J.: I own myself no friend to the almost indiscriminate habit of late years of setting up particular usages or customs in almost all kinds of business and trade, to control, vary, or annul the general liabilities of parties under the common law, as well as under the commercial law. It has long appeared to me that there is no small danger in admitting such loose and inconclusive usages and customs often unknown to particular parties and always liable to great misunderstanding and misrepresentations and abuses to outweigh the well-known and well-settled principles of law. And I rejoice to find that of late years the courts of law, both in England and in America, have been disposed to narrow the limits of the operation of such usages and customs, and to discountenance any further extension of them. The true and appropriate office of a usage or custom is to interpret the otherwise indeterminate intentions of parties, and to ascertain the nature and extent of their contracts, arising not from express stipulations, but from mere implications and presumptions, and acts of a doubtful or equivocal character. It may also be admitted to ascertain the true meaning of a particular word or particular words in a given instrument, when the word or words have various senses, some common, some qualified, and some technical, according to the subject-matter to which they are applied. But I apprehend that it can never be proper to resort to any usage or custom to control or vary the positive stipulations in a written contract, and *à fortiori* not in order to contradict them. An express contract of the parties is always admissible to supersede or vary or control a usage or custom, for the latter may always be waived at the will of the parties. But a written and express contract cannot be controlled or varied or contradicted by a usage or custom, for that would be not only to admit parol evidence to control, vary, or contradict, written contracts; but it would be to allow mere pre-

[1]See *Humphrey v. Dale,* 7 El. & Bl. 266, 278.

sumptions and implications properly arising in the absence of any positive expressions of intention to control, vary, or contradict the most formal and deliberate declarations of the parties.

§212 *SEWELL v. CORP.*

Court of Common Pleas, 1824. [1 *Car. & P.* 392.]

Assumpsit by a veterinary surgeon for attendance and medicines furnished to the defendant's horse. A certificate of the plaintiff's having attended lectures at the veterinary college, signed by Mr. Coleman, the professor there, and several others, was tendered in evidence on the part of the plaintiff.

BEST, C. J., refused to receive it, on the ground that it did not come from any public body known to the law.

Mr. Coleman was called as a witness, and asked by the plaintiff's counsel whether, to his knowledge, it was the custom to pay veterinary surgeons for attendance as well as medicines.

Vaughan, Serjt., objected. There is no custom; this is all modern.

BEST, C. J.: They do not mean a custom whereof the memory of man runneth not to the contrary, but if there is a general usage applicable to a particular profession, parties employing an individual in that profession are supposed to deal with him according to that usage. You may cross-examine as to the extent of the usage. With respect to veterinary surgeons, I know of no law that applies to them particularly. If there is no contract, they must go on a *quantum meruit.* There is a usage for a broker to have commission. If there is a usage here, it is evidence to regulate the claim. I see no objection to the general question as proposed.

Mr. Coleman then stated that the general rule was to charge for attendance when there was not much medicine required.

BEST, C. J.: Such an usage as this is too uncertain.

The plaintiff then went on a *quantum meruit,* and proved several attendances.

Vaughan, Serjt., contended that, by analogy to the case of apothecaries, the jury could not legally give anything for attendances.

The sum of £1 12*s* 6*d*, for the medicine furnished, had been paid into court.

BEST, C. J., left it to the jury to say whether that sum was or was not sufficient for the plaintiff's services and medicines.

Verdict for the plaintiff. Damages, 17*s* 6*d*.

§213 *FLEET v. MURTON.*

Court of Queen's Bench, 1871. [*L. R.* 7 *Q. B.* 126.]

COCKBURN, C. J.: I am of opinion that this rule must be discharged. I quite agree in the propriety and soundness of the decision given by the Court of Exchequer in the recent case of *Fairlie v. Fenton,* L. R. 5 Ex. 169, where the plaintiff contracted as a broker for a principal named, for in that case the principal was named; and I am of opinion that the same principle would apply where the principal is not named, so long as it appears on the face of the contract that the broker is contracting as broker for a principal, and not for himself as principal; and in that case, also, the broker would not be liable on the contract if the principal failed to fulfill his contract. But I think, nevertheless, that the evidence of the custom was admissible, and that after that evidence had been given, the brokers were properly held liable on the contract. For, although where a party contracts as agent there would not, independently of some further bargain, be any liability on him as principal, yet if a man—though professing on the face of the contract to contract as agent for another, and to bind his principal only, and not himself—chooses to qualify that contract by saying that he will make himself liable, though he is contracting for another and giving to another rights under the contract, he himself will incur the same liability as his principal. Now, although where a party professes to contract as broker it might *prima facie* be taken that he contracts without the intention of incurring liability on his own part, yet if by the custom of the particular trade there is that qualification of the contract [which, if written into the contract *in extenso,* would undoubtedly bind him] that qualification may, I think, be imported into the contract by evidence of the custom. In the case of *Fairlie v. Fenton* there was no qualifying circumstance like the custom in the present case. The defendants here undoubtedly call themselves "brokers," acting for their principal. But if the custom attaches, the non-liability which would, under ordinary circumstances, *prima facie* exist in a contract made by a person purporting to contract as broker, ceases, and the contract assumes a different form and character, and carries with it different legal consequences, by reason of the custom of the trade, evidence of which, according to all principles, is admissible to qualify the terms of a contract where not inconsistent with it.

I am of opinion, therefore, that the evidence of custom in the particular trade was properly received by my brother BLACKBURN to fix the liability of the defendants.

I own I entertain somewhat more doubt as to admissibility of evidence of a similar custom in other trades than the particular trade which was the subject-matter of this contract. This case seems to me to go further than the case of *Noble v. Kennoway,* 2 Dougl. 510, which related to the admissibility of evidence of custom in the trade of Newfoundland as applicable to the custom of the trade in Labrador. Labrador had been recently annexed to Newfoundland, and the trade in each was of the same description, it being a trade that related to fishing. By the terms of the contract (a policy of insurance), the ship was to be at liberty to call at Newfoundland, and it might be fairly inferred by persons entering into a contract with reference to the trade of Labrador that what was the custom of the trade of Newfoundland would extend to the trade of Labrador. But this case goes further. At the same time, it is impossible to shut one's eyes to the fact that the moral effect of the evidence would operate on a reasonable mind with very considerable force. If there exists a custom to the effect that the agent makes himself liable, under given circumstances, in a large and extensive trade like the colonial trade, it makes it more probable that in the fruit trade in the Mediterranean, or elsewhere, a similar custom would obtain. I am not quite so clear on the point, but still I do not think that the argument addressed to us goes so far as to show that this evidence was not admissible. There is no doubt that it would be useful in elucidating the truth; and therefore, on general principles, I think the evidence was admissible, and I concur with the judgment which my learned brothers are about to pronounce.

§214 *HARPER v. CITY INSURANCE COMPANY.*

Court of Appeals of New York, 1860. [22 *N. Y.* 441.]

COMSTOCK, C. J.: The jury found, in answer to interrogatories specially submitted to them that the use of camphene in the manner proved was according to a general and established usage in the printing and book business as carried on by the plaintiffs, and that such use was necessary in that business. In the written part of the policy the subject of insurance is described as the plaintiff's printing and book materials, stock, etc., "privileged for a printing-office, bindery, etc." The language is identical with that contained in the policy which was before us in the case of *Harper v. Albany Insurance Company,* 17 N. Y. 194. We there held, for reasons which need not be repeated, that the insurers were liable for a loss occasioned by the necessary and customary use of camphene in the plaintiff's business,

although the use of that article was prohibited in general terms in the printed conditions annexed to and forming a part of the contract. In that case, the printed form of the policy, if construed without reference to the subject of insurance as described in the written part, proscribed the use or presence of camphene for any purpose. In this case, the printed condition declares in substance that if the article is used, and a loss occasioned thereby, the insurer will not be liable. There is no other distinction between the two cases.

And this distinction is not one of principle. In the case cited we found no irreconcilable repugnancy between the written and printed clauses of the contract. If such a repugnancy had been discovered, then, as the court said, the printed form must yield to the more careful and deliberate written language of the parties in describing the subject of insurance at the very moment when the policy was issued. But it was considered that each clause might take effect. By insuring the plaintiffs' stock, with the privilege of a printing-office and book-bindery, the use of such materials, including camphene, as were necessary in that business was allowed; otherwise the contract was a mere delusion. But the restraining clause might nevertheless have its full effect upon the use of camphene for the purposes of light, and for all purposes beyond its necessary connection with the stock and business insured. So, in this case camphene must be considered as a part of the stock insured. Its continued presence and use were allowed, because the business which required its use was expressly privileged. The printed condition exempting the underwriter from loss when occasioned by this article should therefore be construed as referring to uses not within the privilege thus granted; otherwise, the two parts of the contract are repugnant to each other, and the printed form must yield to the deliberate written expression. An insurance upon the plaintiff's stock and business, to be of no effect if a loss should be occasioned by the combustion of an article constituting a part of that stock and necessarily used in the business would, I think, be an anomalous undertaking. Undoubtedly, such a contract might be made. A policy can be so framed as to allow the presence of a dangerous article, and even so as to insure its value, while at the same time it might exempt the insurer from loss if occasioned by the presence or use of the article. But I think it would need very great precision of language to express such an intention. Where camphene or any hazardous fluid is insured, and its use is plainly admitted, the dangers arising from that source are so obviously within the risk undertaken that effect should be given to the policy accordingly, unless a differ-

ent intention is very plainly declared. And such intention, instead of being hid away in printed forms remote from the principal contract, ought to be found in the deliberate expressions which are made use of at the time when the contract is entered into. Without doubt, all the printed conditions and specifications annexed to a policy are, or at least may be, a part of it. But they relate to insurance in general, as practised by the underwriter, and upon or within those forms the parties to each policy actually issued write their own particular intention. The plain meaning of the written part should therefore prevail, and other clauses must yield, if repugnant, or they must be construed so as to avoid a conflict of intentions. In this case, I think the perils of keeping and using camphene were insured against, so far as the keeping or use of it was permitted at all, and that the clause which exempts the insurer from liability should be understood as applying to the presence of the article under other conditions.

The judgment should be affirmed.

DAVIES, WRIGHT, BACON, and WELLES, JJ., concurred; SELDEN, DENIO, and CLERKE, JJ., dissented.

Judgment affirmed.

§215. *Business Usages and Mere Business Facts.*—The point involved in this case is not a business custom or a law pertaining to the business of printing, but simply a business fact; the camphene was used in the printing business and the point of law is that such facts must be presumed to have been in the mind of the contracting parties under circumstances such as these. We see, then, that the practices of a business may influence the interpretation of contracts—whether those practices are so well established as to constitute law or merely presumptions based on custom, or, as in this case, nothing but simple facts. The difference is one of degree.

§216 *SMITH v. WILSON.*

Court of King's Bench, 1832. [3 *Barn. & Adol.* 728.]

LORD TENTERDEN, C. J.: I am of opinion that the evidence was properly received. Where there is used in any written instrument a word denoting quantity, to which an act of Parliament has given a definite meaning, I agree it must be considered to have been used in that sense. But there is no act of Parliament which says one thousand rabbits shall denote ten

hundred, each hundred consisting of five score; and that being so, we must suppose the term "thousand" to have been used by the parties in the sense in which it is usually understood in the place where the contract was made, when applied to the subject of rabbits, and parol evidence was admissible to show what that sense was.

LITTLEDALE, J.: I am of the same opinion. Words denoting quantity are undoubtedly to be understood in their ordinary sense, where no specific meaning is given to them by statute or custom. But here the ordinary meaning of the word "thousand" as applied to rabbits in the place where the contract was made, was one hundred dozen. The word "hundred" does not necessarily denote that number of units, for one hundred and twelve pounds is called a "hundred-weight"; so, where that term is used with reference to ling or cod, it denotes *six* score; and there being, therefore, no precise meaning affixed by the legislature to the word "thousand," as applied to rabbits, I think that parol evidence was admissible to show that in the country where the contract was made the word "thousand" meant one hundred dozen.

§217 *UNITED STATES v. KERR et al.*

U. S. Circuit Court, D. Oregon, 1912. [196 *Fed.* 503.]

WOLVERTON, D. J.: This is an action by the government to recover for overpayment made by it to the defendants on account of the sale by the latter to the former of 2,000 tons of oats at $24.25 per ton, and 2,000 tons at $24.50 per ton; the contract providing that the oats are "to be free from dust and other impurities and to be double sacked with good, strong burlap sacks, not exceeding one hundred and fifty (150) pounds to the sack." The amount sought to be recovered is $595.22, which is the value of the sacks, computed in weight at the price the oats were contracted for per pound; it being the theory of the government that the oats were contracted for net, exclusive of the sacks. Payment was made on the basis of gross weight, including sacks. The defendants, after denying liability, set up what they denominate second, third, fourth, and fifth separate answers. By the second it is alleged:

> "That it is both the general custom of the port of Portland and the general custom of the Pacific Coast that wheat, oats, and grain for exportation or shipment by vessel are bought and sold, and delivered and paid for at the gross weight, without any deduction for sacks; and

that this custom was well known to the plaintiff, and said advertisements were made by the plaintiff, and bids were made by the defendants with full knowledge on both sides of the existence of said custom and in accordance therewith. And it was not intended by either the plaintiff or the defendants that there should be any deduction for the weight of sacks, but that oats should be paid for by gross weight, sacks included."

The third, after setting out the custom as above, alleges:

> "That the value of the sacks required by the advertisement and actually sold and delivered by the defendants to the plaintiff was, to wit, $3,500, and defendants could not and would not have made the bid they did, which was accepted by the plaintiff, giving to the plaintiff said sacks without compensation, and allowing their weight to be deducted from the weight of the grain delivered. That to allow the plaintiff now to make deduction for said sacks, and at the same time to retain the sacks themselves, would be inequitable, and by reason of the foregoing the plaintiff is and ought to be estopped in the premises."

The fourth simply alleges:

> "That the plaintiff voluntarily paid defendants fully, in accordance with the terms of the contract and without protest, objection or notice."

The fifth sets up a counterclaim for the value of the sacks, namely $3,500. To each of these answers the government has interposed a demurrer, assigning as ground therefor that they do not state facts sufficient to constitute a cause of defense.

I am of the opinion that the second further and separate answer is well pleaded. It is no doubt true that usage is never admissible to explain what is clear by the plain terms of the contract, nor can it be allowed to subvert the settled rules of law; that is to say, when settled rules of law are plainly applicable, usage will not be permitted to take the place of or supersede the law. It often occurs, however, that parties do contract with reference to a particular usage, as they may contract with reference to the law existing at the time, and, when so contracting, the usage is to be read into the contract, and will be explanatory of its terms and stipulations. This is especially true where the terms of the contract itself are ambiguous, or their meaning is

not obvious without reference to the usage. In the case of *Robinson v. United States,* 13 Wall. 363, 366 (20 L. Ed. 653), the court says:

> "In the absence of an express direction on the subject, extrinsic evidence must of necessity be resorted to in order to find out which mode was adopted by the parties; and what extrinsic evidence is better to ascertain this than that of usage? If a person of a particular occupation in a certain place makes an agreement by virtue of which something is to be done in that place, and this is uniformly done in a certain way by persons of the same occupation in the same place, it is but reasonable to assume that the parties contracting about it, and specifying no manner of doing it different from the ordinary one, meant that the ordinary one and no other should be followed. Parties who contract on a subject-matter concerning which known usages prevail, by implication incorporate them into their agreements, if nothing is said to the contrary."

The facts of the case from which this quotation is made are in striking analogy to those of the case at bar, and to my mind this case is controlled by that in so far as it respects the second further and separate answer. The stipulation of the contract is that the oats are to be double sacked, and, if we refer to the usage pleaded, it would seem that the oats were sold in gross, the parties contracting with reference to such usage, so that the sacks in reality would be taken and paid for as oats pound by pound. It needs the aid of the custom properly and rightly to construe the contract, and, without it, it would be impossible to arrive at the intention of the parties with reference to the subject-matter.

§218 *SOUTHERN BITULITHIC CO. v. ALGIERS RY. & LIGHTING CO.*

Supreme Court of Louisiana, 1912. [130 *La.* 830.]

PROVOSTY, J.: The present suit is to recover the cost of the paving of that part of Teche street between the rails of the railroad of the defendant company and extending one foot on each side. It is founded upon the following clause of the contract by which the defendant company obtained its franchise:

"Should any paved or unpaved street, occupied by a track or tracks, be ordered paved or repaved, the purchaser shall pay the cost of paving or repaving between the rails of each track, and for one foot on the outside of each rail."

Under the city charter, the abutting property owners have the right to choose the kind of pavement to be used upon the street, if they are to pay any part of the cost. In the present instance they chose bitulithic, and, accordingly, that part of the pavement on which they were to pay a part of the cost was so laid. But the part to be paid for by the defendant was laid in granite blocks. These two kinds of pavements require the same kind of foundation, namely, a six-inch layer of concrete.

Plaintiff was the contractor who did the work. Under the contract, that part of the pavement to be paid for by defendants was to be measured by the square yard, and to be paid for at the rate of $3.95 per yard. The other part of the pavement was to be paid for on the basis of $6.60 per cubic yard of concrete foundation, and $1.95 per square yard of bitulithic surfacing. The difference in the cost of using granite blocks instead of bitulithic on that part of the street to be paid for by defendant was $2,951.13. . . .

Defendant claims a further reduction for the space occupied by the rails, and measures this space by the width of the head of the rails, according to which the space to be deducted would be one-tenth of the whole. And defendant claims a further reduction for the space occupied by the cross-ties, which, being embedded in the concrete foundation, economize that many cubic yards of concrete.

In the latter two claims we find no merit. The work of laying the foundation in that part of the street occupied by defendant's roadbed was very much more difficult and expensive than the rest of the street, owing to the constant passing of cars, and to the presence of the rails and cross-ties which operated as so many obstructions, and, in general, owing to the irregularity of the surface to be paved. Because of this, a different mode of measurement had to be adopted for that part of the work. Nothing is said in the contract about any deduction having to be made on account of the rails in computing the yardage; but we think that by a fair interpretation of the contract such deduction should not be made, as the evidence shows that the presence of the rails adds to the expense of the work very much more than it lessens it. Moreover, the testimony abundantly shows that the usage is not to make such deduction. Usage enters into every contract, and is properly admissible in evidence for the purpose not only of elucidating the contract, but also of completing it. C. C. arts. 1903, 1953; Marcadé, Com. on articles 1135 and 1159, C. N. In *Kernion v. Hills,* 1 La. Ann. 419, proof of usage was admitted as supplementary to a statute.

§219. *Technical Expressions.*—In like manner the custom of the building and plastering trades to make no deductions for doors, windows and wainscoting in estimating the surface covered has been upheld.[1] The point in all these cases is not that a judicial definition is given to words differing from their ordinary definition—the matter is hardly one of interpretation of words—it is simply that a contract cannot be taken by its four corners and interpreted with the aid of the dictionary,[2] regardless of the actual habits, customs, and usages in the light of which the contract was made. Technically, of course, no words are added and the flexible term "interpretation" is used to explain the activity of the court. What actually happens, however, is frequently that the court applies "the law in action" as distinguished from the "law in books" in business matters.

§220 *RHODESIA MFG. CO. v. TOMBACHER et al.*

Supreme Court, Appellate Term, 1911. [129 *N. Y. Supp.* 420.]

BIJUR, J.: . . . The only remaining question was that of acceptance. Defendants showed sufficiently an established custom in the trade to send goods of this kind immediately on receipt to a sponger, by whom they were examined; if then found "shaded," it is the custom for the sponger to notify both the vendor and vendee of the defect. It is clearly shown in the case at bar that this was done. The vendors sent their "adjuster," in the customary endeavor to settle the difficulty, but without avail. The goods remained at the sponger's at the risk of the plaintiff, which persisted in its refusal to admit that the goods were "shaded." Six months afterwards, for further assurance, the defendants had them examined by another sponger, whose testimony confirms that of the first. It is plain that there was no acceptance.

Judgment reversed, and new trial ordered, with costs to appellants to abide the event. All concur.

§221. *The "Adjuster" in Business.*—In this case, custom was relied upon to answer the question, what acts constituted an

[1] *Walker v. Syms* (1898), 118 Mich. 183; *Long v. Davidson* (1888), 101 N. C. 170; *Walls v. Bailey* (1872), 49 N. Y. 464.

[2] In *Houghton v. Gilbert* (1836), 7 C. & P. 701, the entire opinion by Tindal, C. J., consisted of the following remarks: "It is a question of mercantile construction. You had better lay aside your dictionary and appeal to the knowledge of the jury; for, after all, the dictionary is not authority."

acceptance of the goods. The appearance of the "adjuster" in this case is interesting, for he seems to be a new *dramatis persona* in business and one destined to play a very large rôle. The term is borrowed from insurance practise, where the adjuster corresponds to the "claim agent" of railroad companies; to the "complaint department" of public utilities and department stores, the "trouble man" in mechanical trades, and the like. The functions of such a department are generally to make good all minor defects, to settle all small claims, to attempt to compromise the larger ones, and sometimes to gather evidence and lay the foundations for an eventual action or defense through attorneys.

§222 *MOORE v. RUGG.*

Supreme Court of Minnesota, 1890. [44 *Minn.* 28.]

COLLINS, J.: The complaint in this action is not a model, as is admitted by the attorney who drew it, but it appears therefrom that defendant, a photographer, had been employed to make, and had made and sold to plaintiff, a number of photographic portraits of herself, and that subsequently, without the order or consent of plaintiff, he made and delivered to a detective another of these photographs, who used it in a manner particularly stated in the pleading, and claimed to have been highly improper. In justice to defendant, it is right that we should here remark that it is nowhere averred in the complaint that the occupation of the detective was known to him, or that he knew that the photograph so delivered was to be used in the manner stated in the complaint or in any other improper way. This action was brought to recover damages, and this appeal is from an order overruling a general demurrer to the complaint. A good cause of action was therein stated, for which nominal damages, at least, may be recovered. The object for which the defendant was employed and paid was to make and furnish the plaintiff with a certain number of photographs of herself. To do this a negative was taken upon glass, and from this negative the photographs ordered were printed. An almost unlimited number might also be printed from the negative, but the contract between plaintiff and defendant included, by implication, an agreement that the negative for which plaintiff sat should only be used for the printing of such portraits as she might order or authorize. *Pollard v. Photographic Co.,* 40 Ch. Div. 345. The complaint shows that there was a breach of this implied contract.
Order affirmed.

§223. *The Right of Privacy.*—This case presents a question that has been widely discussed under the specious caption "the right to privacy." What is really meant is the interest in one's privacy which the law may or may not protect by creating various rights, but which the law has not undertaken to recognize as such. In this case, the interest can be protected quite easily by reading into the photographer's contract a stipulation based on the custom of the trade to the effect that the negative shall not be used except for the purpose of making copies of the customer's picture according to her order. *Cf.* Warren and Brandeis, *The Right of Privacy,* 4 Harv. Law Rev., 193.

§224 *W. T. SMITH LUMBER CO. v. JERNIGAN, et al.*

Supreme Court of Alabama, 1914. [185 *Ala.* 125.]

DeGRAFFENRIED, J.: . . . Standing alone and unexplained, we would unhesitatingly say that the words "timber suitable for sawlogs" meant any sort of sawlogs, whether oak, chestnut, hickory, poplar, or ash. This deed was made, however, nearly 20 years ago, and it may be that in the section in which this timber was situated the word "sawlogs" had at that time a well-understood local meaning, and that this local meaning was well understood by the parties when the deed was made and delivered. The written reservation in the deed is but the memorial of the contract, the thing upon which the minds of the parties met, and, of course, the thing which they agreed to was the contract between them. If "sawlogs," then had a restricted meaning and the parties used that word in that restricted meaning, the fact that, since that time, the meaning of that word has been broadened does not broaden the rights of appellant. As an illustration: Many years ago it was the universal custom for cotton to be picked from the fields and placed in baskets. These baskets were used by the laborers to carry the cotton from the field to the cotton house. These baskets were made from a particular character of white oak. The words "basket timber" then had, in the cotton sections of the state, a particular local meaning. They meant white oak suitable for making cotton baskets. If a man then sold to a maker of cotton baskets all his "basket timber" his plain meaning would have been to sell that part of his white oak timber which was suitable for making cotton baskets, and only that timber.

In this case the contention is that, when the reservation in the

deed was made, the word "sawlogs" had, in the section of Alabama in which the lands in question were situated, a local, well-defined meaning, and that these words meant pine trees or logs suitable to be manufactured into lumber. If this is true, we see no reason why appellees have not the right, by evidence, to show it. In making this proof, the construction which the parties themselves have placed upon the contract may be shown.—*Kaul, et al. v. Weed, et al.,* 203 Pa. 586, 53 Atl. 489.

"When the usage of the locality in which the instrument is executed has given certain words therein a peculiar signification," the parties to the instrument will be presumed to have used such words in their peculiar local sense.—17 Am. & Eng. Ency. Law, p. 12, subd. 3, and authorities there cited.

§225. *"Construction" and "Interpretation" Stricto Sensu.*—The principle in this case is not unlike that which governs the contract made in a foreign language. In such case translation includes explanation and some law. Here the court takes into consideration not only the peculiarities of a trade and a locality, but also the changes that come about in custom and language with it.

In all of these cases there is no sharp line between simple interpretation and the addition of details based on custom as a kind of undeveloped law. In the following sections we shall confine our attention to interpretation in the stricter sense of the work of the court after all of the evidence is in, when there is no dispute as to the facts of the case or the terms of the contract.

B. Interpretation Given by the Courts.

§226. *Interpretation, a Function of the Courts.*—Two distinct processes are frequently spoken of interchangeably as construction or interpretation. The first is that which we have already examined in several connections, namely, the problem of ascertaining all of the terms of a given contract, particularly the implied terms. As business is ordinarily conducted, every contract has its implied terms, which must be filled out by reference to the usages and customs of the particular business, sometimes by reference to statutes which supply us with convenient "standardized contracts" and frequently by reference to facts and

actions which speak louder than, if not so clear as, words. Even the words used must sometimes be "translated" into non-technical or at least unabridged sentences before we can say that we have all of the terms of a contract before us. When that is accomplished we are ready for the second task, a judicial task, the interpretation of the words of the contract. It is as if we had a written agreement substituted for the aggregate of words and acts that have gone into the making of the contract—and the rules of interpretation laid down for written agreements (§§137, 138, *supra*) apply.

§227. *The Sales Act and Contractual Interpretation.*—A specific illustration of the application of these rules is found in those parts of the Uniform Sales Act in which an attempt is made to determine when title passes in a contract for the sale of goods on the basis of the agreement of the parties.[1] The cardinal rule is, of course, that intention governs. As a matter of fact, the difficulty that generally arises is due to the fact that the parties do not clearly express their intention.

§227a. *Uniform Sales Act, Sections* 18 *and* 19:

18. [*Property in Specific Goods Passes When Parties So Intend.*] (1) Where there is a contract to sell specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

(2) For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties, usages of trade and the circumstances of the case.

19. [*Rules for Ascertaining Intention.*] Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

Rule 1. Where there is an unconditional contract to sell specific goods, in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is imma-

[1] *Cf.* §199, *supra,* on the constructive (or term-supplying) as contrasted with the purely interpretative (or term-defining) phase of the Sales Act. Both are involved in the following sections.

terial whether the time of payment, or the time of delivery, or both, be postponed.

Rule 2. Where there is a contract to sell specific goods and the seller is bound to do something to the goods, for the purpose of putting them into a deliverable state, the property does not pass until such thing be done.

Rule 3. (1) When the goods are delivered to the buyer "on sale or return," or on other terms indicating an intention to make a present sale, but to give the buyer an option to return the goods instead of paying the price, the property passes to the buyer on delivery, but he may revest the property in the seller by returning or tendering the goods within the time fixed in the contract, or, if no time has been fixed, within a reasonable time.

(2) When goods are delivered to the buyer on approval or on trial or on satisfaction, or other similar terms, the property therein passes to the buyer—

(a) When he signifies his approval or acceptance to the seller, or does any act adopting the transaction;

(b) If he does not signify his approval or accceptance to the seller, but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time. What is a reasonable time is a question of fact.

Rule 4. (1) Where there is a contract to sell unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller, with the assent of the buyer, or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

(2) Where, in pursuance of a contract to sell, the seller delivers the goods to the buyer, or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to or holding for the buyer, he is presumed to have unconditionally appropriated the goods to the contract, except in the cases provided for in the next rule and in section 20. This presumption is applicable, although by the terms of the contract, the buyer is to pay the price before receiving the delivery of the goods, and the goods are marked with the words "collect on delivery" or their equivalents.

Rule 5. If the contract to sell requires the seller to deliver the goods to the buyer, or at a particular place, or to pay the freight or cost of transportation to the buyer, or to a particular place, the property does not pass until the goods have been delivered to the buyer or reached the place agreed upon.

§228. *Interpretation as to Warranties.*—A further illustration of the assistance rendered by the Uniform Sales Act in interpretation is contained in the sections on implied warranties, though here we approach and sometimes cross the line separating the "interpretation" of terms from the supplying of terms which we have called "construction."

§228a. *Uniform Sales Act,* Sections 13-16:

Section 13.—(Implied Warranties of Title.)—In a contract to sell or a sale, unless a contrary intention appears, there is:

(1) An implied warranty on the part of the seller that in case of a sale he has a right to sell the goods, and that in case of a contract to sell he will have a right to sell the goods at the time when the property is to pass;

(2) An implied warranty that the buyer shall have and enjoy quiet possession of the goods as against any lawful claims existing at the time of the sale;

(3) An implied warranty that the goods shall be free at the time of the sale from any charge or encumbrance in favor of any third person, not declared or known to the buyer before or at the time when the contract or sale is made;

(4) This section shall not, however, be held to render liable a sheriff, auctioneer, mortgagee, or other person professing to sell by virtue of authority in fact or law, goods in which a third person has a legal or equitable interest.

Section 14.—(Implied Warranty in Sale by Description.)—Where there is a contract to sell or a sale of goods by description, there is an implied warranty that the goods shall correspond with the description and if the contract or sale be by sample, as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

Section 15.—(Implied Warranties of Quality.)—Subject to the provisions of this act and of any statute in that behalf, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract to sell or a sale, except as follows:

(1) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, and it appears that the buyer relies on the seller's skill or judgment (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be reasonably fit for such purpose.

(2) Where the goods are bought by description from a seller who deals in goods of that description (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be of merchantable quality.

(3) If the buyer has examined the goods, there is no implied warranty as regards defects which such examination ought to have revealed.

(4) In the case of a contract to sell or a sale of a specified article under its patent or other trade name, there is no implied warranty as to its fitness for any particular purpose.

(5) An implied warranty or condition as to quality or fitness for any particular purpose may be annexed by the usage of trade.

(6) An express warranty or condition does not negative a warranty or condition implied under this act unless consistent therewith.

Section 16. (Implied Warranties in Sale by Sample.)—In the case of a contract to sell or a sale by sample:

(a) There is an implied warranty that the bulk shall correspond with the sample in quality.

(b) There is an implied warranty that the buyer shall have a reasonable opportunity of comparing the bulk with the samples, except as otherwise provided in section 47 (3).

(c) If the seller is a dealer in goods of that kind, there is an implied warranty that the goods shall be free from any defect rendering them unmerchantable which would not be apparent on reasonable examination of the sample.

§229. *From A. W. Shaw, An Approach to Business Problems* (pp. 105-107).—"Sale by bulk goes back to the first dim beginnings of trade—the barter of a rude stone ax, perhaps, for an ill-tanned deerskin beside the tribal campfire. It persists in all the stages of advancement and occasional retrogression through which commerce and civilization have come together—when buyers and sellers met personally at the market places or fairs, when the traveling artisan went to the home of his customer

and there constructed the cart or chair or coat of which the latter stood in need; when shops were set up in towns and the situation was reversed, the customer seeking the seller. The significant factor in the process was the same in all cases, however. There was personal contact and the buyer saw the actual goods which he was asked to purchase.

Later came sale by sample, where the customer examined and judged, not the actual goods to be received, but a sample which the merchant guaranteed to be similar in type and equal in quality and in every other essential respect to the product which he would deliver. The development of this method of sale was dependent on progress in several apparently unrelated directions. New manufacturing methods made possible a standardization of product as the market widened. It was possible to produce substantially identical articles in large quantities. Grades and standards thus could be established. At the same time there came into being the higher code of commercial ethics necessary to the extension of sale by sample. For the purchaser must have confidence not only in the ability of the producer to furnish goods identical with the sample, but also in his intention to do so.

In sale by description, the purchaser does not see even a sample of the goods. Instead, ideas about the goods are communicated to him by the distributor through the use of salesmen (his own or those of middlemen), advertising, catalogues, booklets, or letters. Spoken, written, or printed symbols take the place of the sight of the goods themselves or a sample of them. The use of the term "symbols" rather than "words" is necessitated by the fact that photographs and drawings today are important factors in sale by description. For a picture of the commodity is frequently able to convey to a prospective purchaser a more vivid impression of the product than could pages of verbal description. In the case of complicated machinery, indeed, the blueprint, with exact dimensions set down and the exact relations between parts made plain, is used to supplement and make clearer the conception which the engineer purchaser acquires by examination of the machine itself.

Sale by description demands a still higher plane of business conduct than is required for sale by sample as well as a higher level of general intelligence. The purchaser must have enough of understanding and imagination to grasp ideas conveyed either through spoken, written, or printed symbols and to visualize the article described and its projected effect on his own business or pleasure. In the backward community, where education is at a low level, sale in bulk and sale by sample must continue as the chief method of distribution. In a sense, therefore, sale by description, whatever its beginnings, is in its modern application a by-product of the public school and of the printing press."

PRACTICE PROBLEMS

(a) The subject-matter of a written contract of sale was "two Harrison Safety Boilers of 150 horse-power each and the services of an erector to set the same." The agreement contained minute specifications of the material and construction of the boilers in all their parts. It was known to the seller that the boilers were to be used by the buyer in Kansas City, and that the only supply of water available there was from the Missouri River. It turned out that the boilers could not be used satisfactorily owing to the amount of mud in the water of the Missouri River. Is the seller liable on an implied warranty that the boilers were fit for the special purpose of the buyer? See *Grand Ave. Hotel Co. v. Wharton* (1879), 79 Fed. 43.

(b) A was a manufacturer of electric motors. B went to A's warerooms to select a motor; after looking over the stock he found one which pleased him, and upon paying the purchase price had it sent to his place of business. After using the motor B discovered that it had latent defects. Some of these defects were shared by all the motors of A's manufacture, and others were peculiar to the particular one B bought. Is A liable to B for either kind of defect?

(c) Plaintiff contracted ptomaine poisoning from chewing tobacco, owing to a foreign substance concealed in the plug of tobacco. What rules of law are controlling with respect to the liability of: (1) the dealer from whom plaintiff bought; (2) the wholesale distributor; (3) the manufacturer? *Cf.* §26, *supra.*

§230 *REED v. INSURANCE CO.*

Supreme Court of the United States, 1877. [95 *U. S.* 23.]

Appeal from a decree of the Circuit Court of the United States for the District of Maryland, affirming a decree of the District Court dismissing a libel.

BRADLEY, J.: This is a cause of contract, civil and maritime, commenced by a libel *in personam* by Samuel G. Reed, the appellant, against the Merchants' Mutual Insurance Company of Baltimore, the appellee, to recover $5,000, the amount insured by the latter on the ship *Minnehaha*, belonging to the libellant. The policy was dated the fourteenth day of January, 1868, and insured said ship in the amount named, lost or not lost, at and from Honolulu, *via* Baker's Island, to a port of discharge in the United States not east of Boston, with liberty to use Hampton Roads for orders, "the risk to be suspended while vessel is at Baker's Island loading." The ship was lost at Baker's Island, where she had gone for the purpose of loading, on the third day of December, 1868. The defense was that the loss occurred whilst the risk was suspended under the clause above quoted; also laches by reason of the delay in commencing suit, being more than four years after the cause of action accrued.

This case, upon the merits, depends solely upon the construction to be given to the clause in the policy before referred to, namely, "the risk to be suspended while vessel is at Baker's Island loading;" and turns upon the point whether the clause means, while the vessel is at Baker's Island *for the purpose of loading*, or while it is at said island *actually loading*. If it means the former, the company is not liable; if the latter, it is liable.

A strictly literal construction would favor the latter meaning. But a rigid adherence to the letter often leads to erroneous results, and misinterprets the meaning of the parties. That such was not the sense in which the parties in this case used the words in question is manifest, we think, from all the circumstances of the case. Although a written agreement cannot be varied (by addition or substraction) by proof of the circumstances out of which it grew and which surrounded its adoption, yet such circumstances are constantly resorted to for the purpose of ascertaining the subject-matter and the standpoint of the parties in relation thereto. Without some knowledge derived from such evidence, it would be impossible to comprehend the meaning of an instrument, or the effect to be given to the words of which it is composed. This preliminary knowledge is as indispensable as that of the language in which the instrument is written. A reference to the actual condition of things at the time, as they appeared to the parties themselves, is often necessary to prevent the court, in construing their language, from falling into mistakes and even absurdities. On this subject Professor Greenleaf says:

> "The writing, it is true, may be read by the light of surrounding circumstances, in order more perfectly to understand the intent and meaning of the parties; but, as they have constituted the writing to be the only outward and visible expression of their meaning, no other words are to be added to it, or substituted in its stead. The duty of the courts in such cases is to ascertain, not what the parties may have secretly intended, as contradistinguished from what their words express, but what is the meaning of the words they have used." 1 Greenl. *Ev.*, §277.

Mr. Taylor used language of similar purport. He says:

> "Whatever be the nature of the document under review, the object is to discover the intention of the writer as evidenced by the words he has used; and, in order to do this, the judge must put himself in the writer's place, and then see how the terms of the instrument affect the property or subject-matter. With this view, extrinsic evidence must be admissible of all the circumstances surrounding the author of the instrument." Taylor, *Ev.*, §1082.

Again he says:

> "It may, and indeed it often does, happen, that, in consequence of the surrounding circumstances being proved in evidence, the courts give to the instrument, thus relatively considered, an interpretation very different from what it would have received had it been considered in the abstract. But this is only just and proper; since the effect of the evidence is not to vary the language employed, but merely to explain the sense in which the writer understood it." Id., §1085.

See *Thorington v. Smith,* 8 Wall. 1, and remarks of Mr. Justice Strong in *Maryland v. Railroad Company,* 22 Id. 105.

The principles announced in these quotations, with the limitations and cautions with which they are accompanied, seem to us indisputable; and availing ourselves of the light of the surrounding circumstances in this case, as they appeared, or must be supposed to have appeared, to the parties at the time of making the contract, we cannot doubt that the meaning of the words which are presented for our consideration is that the risk was to be suspended while the vessel was at Baker's Island

for the purpose of loading, whether actually engaged in the process of loading or not. Taking this clause in absolute literality, the risk would only be suspended when loading was actually going on. It would revive at any time after the loading was commenced, if it had to be discontinued by stress of weather, or any other clause. It would even revive at night, when the men were not at work. This could not have been the intent of the parties. It could not have been what they meant by the words "while vessel is at Baker's Island loading." It was the place, its exposure, its unfavorable moorage, which the insurance companies had to fear, and the risk of which they desired to avoid. The whole reason of the thing and object in view point to the intent of protecting themselves whilst the vessel was in that exposed place for the purpose referred to, not merely to protect themselves whilst loading was actually going on. Her visit to the island was only for the purpose of loading; as between the contracting parties, she had no right to be there for any other purpose; and supposing that they intended that the risk should be suspended whilst she was there for that purpose, it would not be an unnatural form of expression to say, "the risk to be suspended while vessel is at Baker's Island loading." And we think that no violence is done to the language used, to give it the sense which all the circumstances of the case indicate that it must have had in the minds of the parties.

If we are right in this construction of the contract, there can be no uncertainty as to its effect upon the liability of the underwriters. The loss clearly accrued at a time, when, by the terms of the policy, the risk was suspended. The ship sailed in ballast from Honolulu on or about the 7th of November, 1867, and arrived at Baker's Island on the afternoon of the twentieth day of November, 1867. She came to her mooring in safety, and her sails were furled, shortly after which a heavy gale and heavy surf arose. The gale and surf continued with violence until the 3d of December, 1867, when the ship parted her moorings, and was totally wrecked and lost. At no time after her arrival at Baker's Island was it possible to discharge ballast to receive cargo or to commence the progress of loading. The violence of the winds, current, and waves, and their adverse course and direction, prevented the ship from slipping her cables and getting to sea, or otherwise escaping the perils that surrounded her.

These facts are indisputable; and they show that, when the loss occurred, the vessel was at Baker's Island for the purpose of loading. That the process of loading had not actually commenced is of no consequence. The suspension of the risk com-

menced as soon as the vessel arrived at the island and was safely moored in her proper station for loading.

§231 *WALKER et al. v. DOUGLAS et al.*

Supreme Court of Illinois, 1873. [70 *Ill.* 445.]

[A contract, under seal, recited that the party of the first part "has this day sold" to the party of the second part certain property, etc., which was to be paid for in installments, extending through a period of eighteen months. It also contained a clause by which the party of the first part bound himself, in a penal sum equal to double the amount of the purchase money, to convey the property upon payment of all of the installments; and a further clause, that the party of the second part might, at the expiration of two years, elect whether he would affirm the contract, and if he should determine to rescind it, the party of the first part should take back the property, and refund whatever had been paid, with interest from the time of payment.]

SCHOLFIELD, J.: . . . A preliminary question relates to the construction of the contract. It is contended by complainants that the word "sold," being used instead of the words, "agreed to sell," manifests an intention to vest a present equitable title; that the word "sold" is made by our statute a word not only of conveyance, but of warranty also, and that Douglas could not, therefore, forfeit the contract, but his only remedy was to enforce a vendor's lien.

A familiar elementary principle of construction applicable here is, that it is the duty of the court "to discover and give effect to the intention of the parties, so that performance of the contract may be enforced according to the sense in which they mutually understood it at the time it was made; and where the intention of the parties to the contract is sufficiently apparent, effect must be given to it in that sense, though violence be done thereby to its words; for greater regard is to be had to the clear intent of the parties, than to any particular words which they may have used in the expression of their intent." 1 Chitty on *Conts.* (4 Am. ed.) 104-5.

In *Broadwell v. Broadwell,* 1 Gilm. (Ill.) 600, it was said: "In applications for specific performance of agreements, it is immaterial what the form of the instrument is—whether it is a covenant, or a penal bond with a condition to do the thing. The great and leading inquiry is, what did the parties expect would be done?" See, also, *Fitzpatrick v. Beatty, ib.* 468.

We think there is no difficulty here in ascertaining, from the language used, that the parties did not intend or understand

that the contract was in any wise executed, but that it was purely executory, and that no present estate in the property, either legal or equitable, was intended to be vested in Walker.

Douglas bound himself to Walker, in the penal sum of $16,000 for the performance of the conditions of the agreement. One of those conditions is in these words: "Now, it is expressly agreed, *that, upon payment* of each of said notes according to their tenor respectively, *the said Douglas is to convey* to said Walker a good and sufficient title to said premises, with covenants of warranty in respect to title, defending the same against the whole world." What language could have been employed that would have more clearly expressed the idea that title was to be conveyed upon the performance of a future condition? That this form of expression clearly negatives all presumptions that any title was then vested, would seem to admit of no argument. Moreover, by another condition, Walker is allowed two years from the date of the agreement in which to determine whether he will elect to affirm or rescind the purchase of the property; and should he elect to rescind, the payments made are to be treated as in the nature of loans of money, which Douglas is bound to repay, with ten per cent. interest. Manifestly, Walker was not bound to take this property until he exercised his right of electing whether he would have it or not; and it would be absurd to say that Douglas was bound, when Walker was not. In the absence of evidence showing that Walker had waived this right of election, there was not, therefore, an *absolute agreement* even to sell and *convey the property in the future,* much less in the present. . . .

§232. *Stereotyped Expressions.*—At first sight, the result seems to do violence to the words of the contract, "has this day sold." Still, when an expression of this type becomes stereotyped, it is almost like the printed language of a blank form and cannot be taken literally without reference to surrounding circumstances and the other parts of the contract.

§233 *PLANO MFG. CO. v. ELLIS.*

Supreme Court of Michigan, 1888. [68 *Mich.* 101.]

[The written contract, relied upon in this case, reads as follows: "We hereby agree to let Peter Ellis have the sample Plano binder, 1885, at same price that Mr. Ream has his for, and the binder is to do good work, and give satisfaction; and, if not, the said Ellis is to pay for use of same."]

CHAMPLIN, J.: . . . We are of the opinion that the circuit court erred in the construction which he placed upon the contract. A cardinal axiom, in the construction of written contracts, is that all the parts must be examined, and effect given to every word and phrase, if practicable. *Vary v. Shea,* 36 Mich. 388; *Norris v. Showerman,* Walk. Ch. 206, 2 Doug. (Mich.) 16; *Paddock v. Pardee,* 1 Mich. 421; *Howell v. Richards,* 11 East 643. The object is to arrive at the intention of the parties; and this is to be deduced from the language employed by them to express their intention. If the language employed is not free from doubt or uncertainty, resort may be had to the condition of the respective parties, the subject-matter of the contract, and the circumstances surrounding the transaction and connected with it, and everything except the contemporaneous and previous declarations of the parties, for the purpose of enabling the court to ascertain the intention of the parties. *Mills v. Spencer,* 3 Mich. 127, 136. Applying the above principles of construction to the writing introduced as the basis of plaintiff's claim, it is clear that the binder was not only to do good work, but it was to give satisfaction to the defendant. Unless he was satisfied with the machine, although it did good work, he was not bound to purchase. The construction placed on the instrument by the circuit judge completely nullifies the words "and give satisfaction." He construed them as synonymous with, to do satisfactory work, such as people knowing the quality of machines would be satisfied with; or, to use his own language, "this word 'satisfaction' has no further significance than the fact that it should be a good machine, and do good, reasonable work, which would be satisfactory to reasonable men using machinery."

This, certainly, is not the usual signification of the word, and there is nothing in the context, or in the subject-matter, which indicates that the word was used in any other than its ordinary meaning. The vendor had already agreed that the binder should "do good work," and if the learned judge has defined that phrase in the same way he did the word "satisfaction," it would have been applicable and proper. No one can read this writing, and give to the words their ordinary meaning, without understanding that something more was required than that the binder should do good work before defendant was obliged to keep and pay for the machine. He was not obliged to do so, unless, also, it gave satisfaction to him. We may not take judicial notice of the fact, but we may well suppose that there is a choice between machines for reaping and binding that do good work. It may be that a machine which will do good, satisfactory work in reaping and binding, may, at the same time, have more side-draught

than another, or it may be so geared as to require much more power to propel it than another, or its machinery may be complicated and so constructed as to easily get out of repair, or require greater care and skill in operating it. All these things may not be impossible, or even improbable. How, then, can it be said that, although it does good work, nevertheless, it may not [fail to] give satisfaction? Or why should it be said, when the bargainer has reserved the right to elect whether he be fully pleased or not, that he is bound to be pleased if another reasonable or intelligent man is pleased with the work of such machine? There is another clause in the contract which has a bearing upon the question. It is stipulated that if the machine does not do good work, and give satisfaction, the said Ellis is to pay for the use of the same. It cannot be contended, with reason, that Ellis agreed to pay for the use of a machine that did not do good work. This clause implies that it may do good work, and yet not give satisfaction so that he will be willing to keep and pay for it. He agreed that, if it did not do good work, and give satisfaction he would pay for the use of the binder. He was entitled, under the agreement, to give the machine a thorough, practical trial; and then, if he was not satisfied with it, he was to pay for the use of it. This provision entitles the writing to a liberal construction in his favor. It shows that he had an option to accept or reject the binder, according as it gave him satisfaction or not. A proper construction of the contract clearly brings it within the first class of such contracts referred to in *Machine Co. v. Smith*, 50 Mich. 565-569, 15 N. W. 906, and is governed by the decision in that case.

The judgment must be reversed and a new trial granted.

§234. *Agreements to "Satisfy."*—This case is an illustration of the danger attendant upon agreeing to do a particular thing to the "satisfaction" of another party. The older cases went flatly on the theory that the man who was foolish enough to make such a rash promise had placed himself at the mercy of the opposite party. No one but the latter could tell whether he had been satisfied. The later cases make a distinction between matters involving questions of taste and those in which there is practically no personal equation. Thus, if clothing is promised to the satisfaction of the buyer, it seems likely that the older rule would be applied. On the other hand, where a road is made or machinery is constructed, an external standard of satisfaction can easily be substituted as a fair interpretation of the language

of the parties. The case chosen above keeps a middle ground in its argument, but its results when dealing with even a binder, as a matter of taste, shows the influence of the older tradition and the danger of using the expression in a contract. On the other hand, a New York Court has held that a contract to do polishing, staining and rubbing on the woodwork of two houses "to the entire satisfaction of the owner" was complied with by finishing the work in a workmanlike manner. *Doll v. Noble* (1889), 116 N. Y. 230.

§235 *UNITED AND GLOBE RUBBER MFG. CO. v. CONARD.*

Court of Errors and Appeals of New Jersey, 1910.
[80 *N. J. L.* (51 *Vroom*) 286.]

PITNEY, CHANCELLOR . . . The trial judge plainly erred in treating a partial failure of consideration as a complete defence. At the most it would operate only as a ground for abatement of the damages.

But we think there was further error in treating the defence pleaded and proved (if proved it was) as an instance of failure of consideration. The theory was that if the plaintiff's agreement to extend a further line of credit to the Standard Rubber Company was a part of the consideration upon which the bond in suit was given, then if the plaintiff afterwards defaulted in the performance of that agreement there was in a legal sense a failure of consideration.

It is elementary that a promise may be a sufficient consideration for a promise. Pars. *Cont.*, bk. 2, ch. 1 §9; Chit. *Cont.* 50. And it is the promise, and not the performance thereof, that constitutes the consideration, except where by the terms or necessary intendment of the agreement between the parties, performance on one side is made a condition precedent to performance on the other. 9 Cyc., tit. "*Contracts,*" 642.

But in the case before us it will be observed that by the terms of the condition of the bond, the indebtedness already due from the Standard company to the plaintiff was to be paid upon demand when due, while the alleged further line of credit was to be extended from time to time as merchandise might be required by the Standard company. This court has recently held that where there are mutual promises, and the time for performance by one part may arrive before the time for performance by the other, the latter promise is an independent obligation and not a

condition precedent of the former, and its non-performance does not constitute a bar to an action upon the former promise. *Kinney v. Federal Laundry Co.*, 46 Vroom 497.

It seems to us, therefore, that the plaintiff's promise to extend the further line of credit (if it was in fact made and was sufficiently definite to amount in law to an agreement) was at most an independent undertaking, the non-performance of which does not constitute a bar to the plaintiff's action upon the bond.

For these reasons it seems to us the trial judge erred in refusing plaintiff's request to charge above mentioned, and likewise erred in the instruction given to the jury in the respect pointed out by the plaintiff's exception thereto.

The judgment under review should be reversed, and a *venire de novo* awarded.

For affirmance—None.

For reversal—THE CHANCELLOR, CHIEF JUSTICE, GARRISON, SWAYZE, TRENCHARD, PARKER, BERGEN, VOORHEES, MINTURN, BOGERT, VREDENBURGH, VROOM, DILL, CONGDON, JJ. 14.

§236. *Interdependence of Covenants, a Problem of Interpretation in Part.*—The reason for taking up the question of the interdependence of covenants in a contract under the general heading of Interpretation is that since Lord Mansfield's day courts have tended to make the distinction between conditions precedent and independent covenants, turn on the intention of the parties, as in the above case. The older cases, however, made the matter turn on pleading. The all-important question was whether performance of a certain stipulation had to be set out in one's declaration before he could ask for the assistance of the court. The older cases, therefore, had to draw the lines more clearly, if more arbitrarily, between the several kinds of covenants.

Frequently the non-performance of his promise by the other party is an excuse from the reciprocal duty to perform, and it does not seem possible to reduce every such case to a simple question of interpretation. On this compare the reasoning in the older cases, below, and see Williston's note in Wald's Pollock on *Contracts* (3d ed.), p. 323, and Williston on *Contracts,* where the doctrine of the excuse of non-performance by the plaintiff is assimilated to the doctrine of failure of consideration, §§120,

121, *supra.* *Cf.* also the provision of §45 in the Uniform Sales Act, which adopts the element of the materiality of the breach, whether by the seller or the buyer, as the test of the other party's right to refuse to proceed further under the contract.

§237 *MILL DAM FOUNDRY v. HOVEY.*

Supreme Judicial Court of Massachusetts, 1839. [21 *Pick.* 417.]

SHAW, C. J.: . . . In construing this contract, and applying it to the facts in the case, the great difficulty is, in determining which of these numerous provisions are conditions precedent, and which are mutual and independent stipulations. It seems to be well settled, that when there is a stipulation amounting to a condition precedent, the failure of one party to perform such condition will excuse the other party from all further performance of stipulations depending upon such prior performance. But a failure to perform an independent stipulation, not amounting to a condition precedent, though it subject the party failing to damages, does not excuse the party on the other side from the performance of all stipulations on his part. *Havelock v. Geddes,* 10 East, 555; *Boone v. Eyre,* 1 H. Bl. 273, note.

The general statement of the principles of law adopted, and which were embraced in the instructions to the jury, were as follows: That this was substantially a contract for work and labor, to be done by the defendant for the plaintiffs, he to work on their materials with their tools and apparatus, upon their premises; that the property in the materials being theirs when furnished to the defendant, the property in the manufactured articles was theirs when completed, and in all stages of the process of manufacture; that by the agreement the defendant acquired no interest in the nature of a leasehold, in the premises, but a license therein, to enter upon and use them for the purposes of the contract; and in contemplation of law, he was to be employed on premises, of which the plaintiffs were in possession; that the defendant, in order to excuse or justify a non-performance on his own part, must show some non-performance on the part of the plaintiffs of some stipulation, operating as an express or implied condition, on the happening of which, either by the express terms of the contract or by the impossibility of proceeding further on his part, he was to be exempted from further performance. The jury were further instructed, that when there are in a contract many mutual and executory stipulations, on both sides, in determining which are provisional and dependent and constitute conditions precedent, and which are mutual and

independent, it is proper and necessary to consider the objects and purposes of the contract in its full extent, and to examine every provision and clause in the whole instrument, to determine the meaning and intent of the parties, and that in case of doubt, such a construction ought to be adopted, as may be best adapted to carry into effect the intent of the parties.

It was further held, that in order to construe a stipulation on one side, to be a condition precedent to an obligation to perform on the other side, it must in general appear, either:

1. That the undertaking on one side is *in terms* a condition to the stipulation on the other; as where one stipulates that he will perform the thing to be done, if the other shall have first performed some stipulation on his part; and even when words are used, which might be construed to be a condition in their ordinary sense, they shall not be so considered, if such construction is not consistent with the intent of the parties. *Storer v. Gordon,* 3 Maule & Selw. 308. The rule laid down in *Ritchie v. Atkinson,* 10 East, 295, and *Atkinson v. Ritchie,* ib. 530, is this, that whether a thing be a condition precedent depends on the reason and sense of the thing as it must have been understood by the parties, and it is to be collected from the whole contract; Or,

2. It must result from the nature of the acts to be done, and the order, in which they must necessarily precede and follow each other in the progress of performance. When the act of the one party must necessarily precede any act of the other, as where one stipulates to manufacture an article from materials to be furnished by the other, and the other stipulates to furnish the materials, the act of furnishing the materials necessarily precedes the act of manufacturing, and will constitute a condition precedent, without express words. *Thomas v. Cadwallader,* Willes, 496. But when the act of the one is not necessary to the act of the other, though it would be convenient, useful, or beneficial, yet as the want of it does not prevent performance, and the loss and inconvenience can be compensated in damages, the performance of the one is not a condition to the obligation to perform by the other: Or,

3. The non-performance on one side must go to the entire substance of the contract, and to the whole consideration, so that it may be safely inferred as the intent and just construction of the contract, that if the act to be performed on the one side is not done, there is no consideration for the stipulations on the other side. And therefore though there be a breach of an express or implied covenant on one side, attended with some loss and damage to the other, yet if it does not go to the whole consideration, and the loss can be compensated in damages, the stipulation must

be construed to be independent, for breach of which the party sustaining such loss has his remedy by action, but it is not a condition precedent, upon the non-performance of which the other party is absolved from the performance of the stipulations on his part.

The principle may be illustrated by reference to stipulations in this contract. In the contract as it was first made, the company covenanted to keep the tools in repair, with certain exceptions; in the subsequent agreement, this was modified, and the defendant stipulated, with some exceptions, to keep the tools in repair. A failure to perform this stipulation, in any particular, would have been a breach of contract, and might occasion delay and loss to the other party; but not being made in terms a condition to the performance of the other, nor being in the strict sense of the term necessary to the performance of the other party, and not going to the whole consideration for the engagements on the other side, it would not be the breach of a condition precedent, absolving the other party from further performance, but an independent stipulation, the breach of which would be a cause of action for damages. *Stavers v. Curling,* 3 Bingh. New Rep. 355.

These general views of the law, as they were expressed at the trial, and laid down and illustrated in the instructions to the jury, are approved and sanctioned by the Court, as principles and rules of law well settled upon principle and authorities, and applicable to the present case. But in applying them to the present case, and in the construction put upon the stipulation of the plaintiffs, in regard to furnishing mill power for the execution of the contract, by the defendant, a majority of the Court are of opinion, that the jury were not correctly, or rather were not fully and sufficiently instructed, and that for this reason the verdict ought to be set aside, and a new trial granted; and in that opinion I concur.

The stipulation of the company, upon which the question arises, is as follows: "The said proprietors also agree to give to the said Hovey, with the exception of the power conveyed to the boiler-house, as now used, the exclusive use, or an equivalent thereto, of the south water-wheel, drums, gears, belts, etc., belonging thereto, during regular working hours, whilst he is employed in making said plane and moulding irons, they to keep same in good repair, [this altered by the subsequent agreement], and to furnish the said Hovey and give him the control of all the tools, machinery, room and furnaces now in use, or which may be added to the plane-iron establishment."

The questions are:

1. What is the true construction of these stipulations—that is, what was the understanding and intent of the parties, as expressed by their respective stipulations? and

2. Which of them may be considered to be conditions precedent, upon the non-performance of which the other contracting party is excused from further performance?

The distinction is now well settled, between an obligation or duty imposed by law, and that created by covenant or act of the party. When the law creates a duty, and the party is disabled from performing it, without any default of his own, the law will excuse him; as in waste to a tenement, if the same be destroyed by tempest or enemies, the lessee is excused. But when the party by his own contract creates a duty or charge upon himself, he is bound to make it good, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract. 2 Williams' Saund. 422a. note 2. The good sense of the rule seems to be this, that in a case where, if an event happen, it must inevitably cause loss and damage to one or the other of the contracting parties, the party who has contracted that such an event shall not happen, although he cannot specifically perform that contract, because the event may happen through the act of God or inevitable necessity, yet he shall stand to that risk, and make good all the loss which shall occur in consequence of the happening of the event contemplated. The party thus contracting takes the consequences. If the act to be done is so far a condition precedent, that upon the failure to perform, the other cannot execute his part of the contract, he is absolved from further execution, although caused by means over which the contracting party had no control. But if the failure is such as not to prevent the other party from executing, though it may subject him to inconvenience, yet it is the breach of an independent covenant, if a breach at all, and may give the other party a claim for damages by action, to indemnify him against the loss actually sustained.

But in construing such a contract, to determine whether there be a breach, especially when expressed in general terms, it would not always conform to the intent of the parties, to construe every stipulation literally, when implied qualifications and exceptions are obviously necessary, to carry into effect the intentions of the parties, to be collected from the whole contract, and to be examined under the lights thrown upon it by the obvious purposes and objects to be accomplished by it. Parties who enter into a contract in reference to the carrying on any breach of business are presumed to know and understand how that business is usually carried on, how it must necessarily be con-

ducted, and to have reference to such known circumstances in their contracts. For instance, should a party having possession of a manufactory, with a water power only, stipulate with another having adjoining premises, to furnish these premises with water power, during all regular working hours for several years, without exception, we think it is to be presumed that they know that such power may be, and must necessarily be occasionally interrupted; that on a few very cold days in winter the ice will so clog the wheel, that it may take several hours to clear it, that a freshet may carry away a gate, which it will take a few days to replace; and the covenants, though in general terms, are to be taken with these necessary and implied exceptions. What are to be deemed occasional interruptions, and what a reasonable time to remove them must depend upon the subject-matter, the knowledge and experience of those conversant with the subject, and all the circumstances of the case, as applied to the subject-matter, and the nature and terms of the contract. This is the principle expressed in the opinion formerly given, in an earlier stage of this case, that where a stipulation is made in general terms, it is to be construed with such implied exceptions and qualifications, as necessarily grow out of the subject-matter, and therefore must be presumed to have been in the contemplation of the parties. The principle is, that when both parties contemplate an end to be accomplished by definite means, they know how these means are to be applied, and they expect that the end will be accomplished, as such an end is known by experience to be and must necessarily be accomplished by such means and not otherwise.

But the question recurs upon the meaning and effect of this stipulation of the company, and in this respect a majority of the Court are of opinion that the instruction to the jury was incorrect or deficient.

The company covenanted to give the defendant the use of the south water-wheel or an equivalent. That this was a stipulation for the use of mill power, and not a demise of any part of the works, is manifest from the exception. The exception is of the power conveyed to the boiler-house. The subject excepted, being out of the subject granted, must be of like kind, and in this case must be power. And of course the alternative stipulation to furnish an equivalent must be construed to mean an equivalent power, for the purposes for which it was to be applied, in manufacturing the irons to be made, conformably to the objects and purposes of the contract. The Court are of opinion, that under this contract the company had the election to furnish the one power or the other, not only at the commence-

ment, but afterwards during the whole time contemplated for the execution of the contract, and that they might change from one to the other, from time to time, it being done without occasioning delay or inconvenience to the other party. The force of the south water-wheel was the measure of the power applicable to manufacturing purposes which the company undertook to furnish, and the mode was at their option. The execution of so large a contract contemplated a considerable lapse of time, and the contract itself looks to changes and alterations in the works during the time, by a provision, not only that the defendant was to have the control of the machinery, room, and furnaces then in use, but such as might be added to the plane-iron establishment.

And as the company had an election to furnish the one power or the other, at their option, so they were bound to furnish one or the other, during the whole time, subject to such occasional and casual interruptions, as must necessarily attend the use of mill power. The rule of law is, that where the condition of a bond is to do one of two things, if one cannot be performed, unless it has become impossible by the act of the obligee, the obligor is bound to perform the other. To apply these rules to this alternative contract; if the water power failed, and could not be restored within a reasonable time, regard being had to the nature and extent of the contract, and the time limited for its fulfilment, and a steam power of equal value for mill purposes, could be furnished within a reasonable time and at a reasonable cost and expense, the company were bound to furnish such an equivalent steam power. If this power was furnished within a reasonable time, and without unreasonable restrictions and limitations upon the use of it, and placed substantially under the control of Hovey, then the company complied with their contract in this behalf, and there was no breach of a condition precedent, which absolved the defendant from further performance on his part. But, supposing the water power could not be restored within a reasonable time, and a steam power could be furnished at a reasonable expense, if the company did not furnish this power within a reasonable time, and did not place it substantially under the control of the defendant, then there was a breach of contract on their part.

And the Court are of opinion, that as the defendant's contract was to work on the premises of the company, with their machinery and apparatus, the furnishing of mill power was a condition precedent to the performance of the defendant, because without it no essential part of the work could be done. But this is to be taken with considerable qualifications:

1. Such breach of the condition could only excuse the defendant from such part of the contract, requiring the use of mill power, as remained to be performed, when the breach of condition happened.

2. A mere slight, temporary, and inconsiderable suspension of the mill power, not manifesting any deliberate purpose of the company to withdraw or withhold the power, would not amount to the neglect or refusal to furnish power which would constitute a breach of condition. There must be some vote of the company, some deliberate act on the part of their authorized agents, showing an intent and purpose on their part to withhold the mill power, or such continual neglect, after notice and knowledge of its failure, as to manifest such intention. It is not therefore any temporary casting off of bands or other temporary interruption of the mill power, even by an agent of the company, which would amount to a breach of a condition precedent. To have that effect, the law looks to such substantial refusal or neglect to furnish mill power, as puts it out of the power of the other party to proceed in the execution of his contract.

3. Although such suspension or interruption of the mill power might be construed to be the breach of a condition precedent, which would warrant the other party to break off, and excuse the further performance of the contract, yet it is at his option to do so, or to waive the breach and proceed with the contract. And if he continues in the performance of the contract, until the impediment is removed and the power re-established, this amounts to a waiver of the forfeiture, and the party will not longer be excused thereby from the further performance of the contract.

And in reference to this part of the case, and with a view to a new trial, if one should take place, the Court thinks it proper to add, that if the evidence should be as it has been on every trial heretofore, whether the failure to furnish the stipulated power, between the time of the breaking of the dam and the completion of the steam-engine ready for use, was the failure of a condition precedent or not, warranting the defendant to give up the performance of the contract, is immaterial, because in fact, as that evidence shows, he went on with the execution of the contract, until the steam-engine was put in motion, and ready for use, about the 7th of December. And such continuance was a waiver of the breach of condition to that time.

§238 *ELLIOT v. CARNEAL.*

Court of Appeals of Kentucky, 1820. [2 *A. K.* Marsh. 308.]

BY THE COURT: . . . Covenants are classed in law, where stipulations are to be performed on both sides, into dependent and independent, conditional and unconditional. In the first class, the party in whose favor the condition is, is not bound to act till the condition is performed by the other party. In addition to the remedy which the law may give him for a breach, he has the additional security of withholding the consideration, and may also bring his action for the breach. In the second class, the parties rely on the remedy afforded by law, and each may be liable for a breach, to an action. To which of these classes the present covenant belongs no person can reasonably doubt from its language, and the condition precedent was to have been performed by Carneal before he could have any claim against Elliot. The words in favor of Elliot, before he performed the stipulations on his part, are express, that *for the consideration* and *on the condition* thereafter mentioned, to wit, the performance by Carneal of his part, he (Elliot) was to perform his agreement and give up Calquhoun's note. On the contrary, the stipulation on the part of Carneal is absolute and unconditional. He was to perform at all events, and rely on his action at law if Elliot thereafter failed. He seems to predicate his first plea on the idea that he acquired the right to the note of Calquhoun, although he performed nothing himself of the condition precedent, and that thereafter, notwithstanding his own entire failure, which remained unanswered by the plea, Elliot lost his control over the note; or that Elliot by his retaining the note and putting it in suit against Calquhoun, after his (Carneal's) failure, forfeited his right of action, and was barred of his suit against him (Carneal). Such a position is wholly inadmissible. As well might it be said that if Elliot had stipulated to pay money for the whiskey, and had prepared it for the purpose, if he used it after Carneal's failure, he forfeited his right of action. His cause of action was complete on Carneal's failure; and his using the consideration to be given to him afterwards, could not release Carneal. It is unnecessary to enquire what remedy, or whether any, Carneal may have for the value of the note against Elliot, if Elliot recovers in this suit; for it is clear he cannot make it a bar to this action. The first plea is then wholly insufficient, and ought to have been overruled by the court below.

Nor is the second plea deemed any better. It relies, in part, on the same or similar matter with the first; to wit, the continuing to hold and coerce the payment from Calquhoun of the

note. But it also states additional ground. It assumes the ground that the condition precedent was to be performed by Elliot—when it was to be done by himself. It supposes it to be necessary for Elliot to be present at the day and place of performance with the note of Calquhoun, and that he, Carneal, had a right to guess that Elliot would not be there, and on the strength of it, to fail entirely himself, and if Elliot was not there he could pay off his obligation by Elliot's absence; when, it is clear, that by depositing the produce at the warehouse, subject to Elliot's order, or retaining it on board of his boat till Elliot or his connections had notice, according to the contract, without the presence or concurrence of Elliot, he might have discharged his covenant and made his cause of action complete. This plea is therefore adjudged wholly defective also; and the judgment of the court below sustaining these pleas, must be reversed with costs, and the cause remanded, with directions to sustain the demurrers to both the first and third pleas of the defendant, and proceed to try the issue on the second.

§239 *McCORMICK v. BADHAM.*

Supreme Court of Alabama, 1914. [191 *Ala.* 339.]

McCLELLAN, J.: . . . (1) Whether parties to a contract have stipulated as for dependent or independent covenants, in respect of the obligations assumed thereunder, is, of course, a matter of intention, common to both, to be collected from the contract itself, together with the circumstances surrounding the parties at the time and those attending the engagement they make, and in the light of the common sense of it. *Nesbitt v. McGehee,* 26 Ala. 748, 755, 756; *Fulenwider v. Rowan,* 136 Ala. 287, 34 South. 975; *Loud v. Pomona Land Co.,* 153 U. S. 564, 14 Sup. Ct. 928, 38 L. Ed. 822.

(2) "The parties have an undoubted right, if they please, to make their covenants dependent or independent throughout, or to make the covenants independent as to one thing, and dependent as to another. They have a right to mould their contracts to suit their mutual convenience and interests; and, when the courts can ascertain their meaning, they are so to construe the contract as to give effect to that meaning, provided the purpose be lawful. They must be held to have intended the performance of their respective acts, in the order of time indicated by their covenants." *Nesbitt v. McGehee, supra.* The precedency of covenants "must," as said by Lord Mansfield in his quotation in *Nesbitt v. McGehee,* "depend on order of time in which the intent of the transaction requires their performance."

(3) "Where a specified thing is to be done by one party as the consideration of the thing to be done by the other, it is undeniably the general rule that the covenants are mutual, and are dependent, if they are to be performed at the same time, and if, by the terms or nature of the contract, one is first to be performed as the condition of the obligation of the other, that which is first to be performed must be done, or tendered, before that party can sustain a suit against the other." *Phillips Const. Co. v. Seymore*, 91 U. S. 646, 650 (23 L. Ed. 341); *Loud v. Pomona Land Co., supra.*

(4) Our interpretation of the contract accords with that prevailing in the court below, viz., that the payment of the price for the stock with dividends accruing thereon, after the indebtedness mentioned had been discharged, was a condition precedent to any obligation on Badham to transfer the stock to McCormick, or to any right in McCormick to require a transfer thereof by Badham to him.

§240 *NATIONAL MACHINE AND TOOL COMPANY v. STANDARD SHOE MACHINERY COMPANY.*

Supreme Judicial Court of Massachusetts, 1902. [181 Mass. 275.]

HOLMES, C. J.: This is an action of contract upon one or two small claims and for the breach of a contract made in March, 1900, by certain letters, in which the plaintiff undertook to manufacture certain portions of a patented machine, according to a schedule attached to the defendant's order. This last is the main source of trouble. With regard to payment the plaintiff wrote: "If you should favor us with an order for a considerable number of these parts, we would bill them up to you as they were finished, and would merely ask that the bills be settled promptly as they came to you." At a later stage of the negotiation the plaintiff wrote that it should expect the defendant "to arrange it so that the bills would be approved promptly, and payment made on same at once, so that we may expect payments coming in rapidly after we have got well started on the contract, thus preventing us from having too large an amount of money tied up in the work." In this letter the plaintiff also wrote that it expected the defendant "to fully protect us from any suits that might be brought against us while we are on this work, on account of patents." It is denied that this letter was a part of the contract. We see no sufficient reason for the denial. . . .

On May 17, 1900, the plaintiff having finished one item on the defendant's order, of sixty adjusting screws, sent a bill for the price, $90. The bill bore a stamped notice that "all claims

for corrections in this bill must be made within ten days from date.'' It was understood by the plaintiff that if the bill was approved by the proper man it would be sent on to New York to be paid. Three or four days later there was a conversation in the defendant's Boston office, it was suggested that this bill ought to be paid immediately on presentation and complaint was made with regard to another overdue account of nearly seven hundred dollars ($697.23). There were apologies and further delays, complaints and explanations, the defendant's representative always explaining the delay as accidental, and finally, on May 28, stating that the check was ready but had been retained for entry as the bookkeeper was away. This last seems to have been true. On May 29 the plaintiff, hearing that a check had not come on, notified the defendant that ''as you have not lived up to your agreement with us in relation to the work we are doing for you, we shall stop all of your work today,'' and stopped. Later efforts to come to an understanding failed.

The plaintiff when it stopped work had finished another small item of $24, and on May 31 offered to deliver these goods as well as those for which the bill for $90 had been sent, but the defendant declined to receive them. May 31 was the date of the writ, and the plaintiff very candidly says that the offer was made after suit was brought. The plaintiff seeks to recover as damages for the defendant's alleged breach the cost of the finished parts, and also the value of stock and castings and a large amount of work upon parts never delivered or completed.

The case was sent to an auditor. He found that the defendant did not repudiate the contract, and that the delay in payment did not justify the plaintiff in stopping work. The judge of the Superior Court adopted his rulings and findings, although finding in addition that the provision for prompt payment of bills for finished work was material, and that payment was not made promptly, and expressing a doubt whether the plaintiff was not justified in refusing to proceed.

Although the contract was not repudiated by the defendant, we are of opinion, notwithstanding *Winchester v. Newton,* 2 Allen, 492, which perhaps was not intended to establish a different general rule (see also *Newton v. Winchester,* 16 Gray, 208), that there might have been such a breach by failure to pay, as, however honest and however little it expressed a repudiation, would warrant a refusal to go on with the work. *Bloomer v. Bernstein,* L. R. 9 C. P. 588. See *Stephenson v. Cady,* 117 Mass. 6. There is nothing to the contrary in *Daley v. People's Building, Loan & Saving Association,* 178 Mass. 13, 18. What is said there refers to an attempt to avoid a contract *ab initio* for a

refusal to pay money due upon an executed consideration, when to make that payment is all that remains to be done on that side.

We may say further that for the purposes of this decision it is not necessary to consider Lord Selborne's somewhat sweeping suggestion in *Mersey Steel & Iron Co. v. Naylor,* 9 App. Cas. 434, 439, that when delivery of an installment of goods under an entire contract is to precede payment for the goods delivered, as payment cannot be a condition precedent of the entire contract, it cannot be a condition precedent to the deliveries remaining to be made, at least without express words. See *Norrington v. Wright,* 115 U. S. 188, 210. In this case both parties have assumed that the plaintiff could put the defendant in default without delivery merely by sending a bill for an item when it was finished, so that Lord Selborne's logical difficulty, if there is anything in it, does not apply.

The question before us therefore is whether the defendant's failure to pay $90 promptly was a breach going to the root of the contract—a breach so important as to warrant the plaintiff in refusing to go on without defeating his own right to recover upon it or rescinding the contract. My brother Loring and I have not been able to reach a clear conviction that it was such a breach, in view of the smallness of the sum, the indefiniteness of the terms of the contract as to the time for payment (see *Harnden v. Milwaukee Mechanics' Ins. Co.* 164 Mass. 382; *Parker v. Middlesex Mut. Ass. Co.,* 179 Mass. 528, 531) the shortness of the delay, and some other circumstances. Of course not every trifling breach of contract excuses the other side from further performance. *Honck v. Muller,* 7 Q. B. D. 92, 100; *Mersey Steel & Iron Co. v. Naylor,* 9 App. Cas. 434, 444; *Dubois v. Delaware & Hudson Canal Co.,* 4 Wend. 285, 289. *Wright v. Haskell,* 45 Maine, 489, 492. *Weintz v. Hafner,* 78 Ill. 27, 29. *Worthington v. Gwin,* 119 Ala. 44, 54.

But my brethren are of opinion, and I dare say wisely, upon the findings, that the plaintiff was warranted in its course. The plaintiff's contract necessitated a considerable preliminary outlay, and would necessitate further expenditures in carrying out its part. At the time it was paying nearly seventy dollars a day. Prompt payment for goods as finished took the place of payments on account. The plaintiff was sensitive, and had a right to be so, at any appearance of uncertainty as to the stipulated payments being made. It had a further ground of anxiety in the suits brought against it for infringement of patents, when it had only the defendant's personal guaranty to protect it. Under such circumstances, the failure to pay the other bill for nearly seven hundred dollars, gave a character to the failure to

pay the smaller sum which was due, and imparted a significance to the delay that otherwise it might not have had. A failure to pay a small sum promptly because of difficulty in raising the money is not the same thing as, and may have a greater effect than, a similar failure simply because of the absence of a bookkeeper or of some misunderstanding between the defendant's Boston and New York houses.

PRACTICE PROBLEM

(a) Defendant agreed to buy 5,000 tons of rails of the plaintiff, shipment to be at the rate of about 1,000 tons per month, beginning in February, and delivery to be completed within six months. Plaintiff's shipment for February was 400 tons, for March 880 tons, and for April 1570 tons. Defendant received and paid for the February shipment, but upon learning in May for the first time the amounts shipped in February, March, and April, defendant gave notice of his refusal to accept the March shipment as well as all subsequent shipments. What are the rights of the parties? See *Norrington v. Wright* (1885), 115 U. S. 188.

C. Rights and Duties of Third Parties.

§241 *DOREMUS v. HENNESSY.*

Supreme Court of Illinois, 1898. [176 *Ill.* 608.]

PHILLIPS, J.: Appellee instituted an action on the case, alleging that in 1890, and several years prior thereto, she was conducting a laundry office in the city of Chicago, where she received clothing from various customers, to be laundered; that she did not own a laundry plant herself, but employed other operating laundries, who, when the work was done, returned the same to her for delivery to her customers; that she had built up a good and profitable business; that appellants conspired to injure her in her good name and credit, and to destroy her business, because she would not increase the price charged by her to customers in accordance with the scale of prices fixed by an organization known as the Chicago Laundrymen's Association, and to that end willfully and unlawfully, by intimidation and unlawful inducements, caused parties who were doing her work (five of whom were mentioned in the declaration) to refuse to longer do the same, and by threats, intimidation, false representations and unlawful inducements caused others who were operating laundries (who were specifically designated in a bill of particulars) to refuse to take or do her work; that this was done for no justifiable purpose, but to cause loss to the plaintiff and injure and destroy her business; that various persons with whom

she had engagements to so do her work, in consequence of the acts of the appellants, broke their contracts with her, and the business she had built up as a laundry agent was destroyed and entirely broken up, and she thereby sustained great loss and damage by reason of appellants so contriving, plotting and conspiring, by the means aforesaid, to break up and destroy her said business.

The evidence shows that plaintiff had a contract with one Miller, who operated a laundry, and who agreed to do her work and give her two weeks' notice before he would quit doing it, and that through the interference of appellants he refused to do her work without giving the notice agreed on. Subsequently she applied to other laundrymen, who agreed to do her work as long as the laundry association did not interfere. She made arrangements with other laundries, by written agreement, by which her work was to be done. In one case the contract was for a year, and according to the testimony in this record that contract was broken by the party contracting with her almost as soon as made. One contract with Joseph Apple, by which her laundry work was to be done for one year, was violated. The officers of this association, as testified to by the witness who entered into the contract with appellee, interfered, and sought to injure the plaintiff by having him keep back her work, retaining it as long as possible, to her detriment, and also by having him retain parts of the work. He testifies: "They told me that they would give me $300, a horse and wagon, and enough work to keep me going, provided I would keep back her work and retain it as long as I possibly could, to the detriment of her patronage. That was at the first meeting, and I agreed to that. I kept a bundle out. At the second meeting they made threats to me if I didn't accept that they would ruin my business at any rate, as well as hers." Another witness who agreed to do her work as long as the laundry association would let him alone, was induced, by threats of destroying his business, to cease connection in business with appellee. The evidence shows that appellants were active in inducing these various breaches of contract, as well as other contracts entered into between her and various parties engaged in operating laundries.

Issues were joined, and upon a trial in the circuit court of Cook county defendants were found guilty and the plaintiff's damages were assessed by a jury at $6,000. Motions for a new trial and in arrest of judgment were overruled and judgment was entered on the verdict, to which defendants excepted. On appeal to the Appellate Court for the First District the judgment was affirmed, and this appeal is prosecuted.

The contention of appellants is, that they cannot be held liable for merely inducing others to break their contracts; that the parties who broke their contracts were the only ones liable, they being free agents and not coerced or influenced by force or fraud; that their acts in inducing parties to break their contracts with appellee were not mere malicious acts, done solely with the intent to injure her, but were in the line of legitimate trade competition, for which they cannot be held liable; nor can they be held liable, they claim, for acts which are charged to have been done in pursuance of a conspiracy, as it is insisted that a conspiracy does not create a liability in a civil action, as the damage illegally done, and not the conspiracy, must be the gist of the action.

The common law seeks to protect every person against the wrongful acts of others, whether committed alone or by combination, and an action may be had for injuries done which cause another loss in the enjoyment of any right or privilege or property. No persons, individually or by combination, have the right to directly or indirectly interfere or disturb another in his lawful business or occupation, or to threaten to do so, for the sake of compelling him to do some act which, in his judgment, his own interest does not require. Losses willfully caused by another, from motives of malice, to one who seeks to exercise and enjoy the fruits and advantages of his own enterprise, industry, skill and credit, will sustain an action. It is clear that it is unlawful and actionable for one man, from unlawful motives, to interfere with another's trade by fraud or misrepresentation, or by molesting his customers or those who would be customers, or by preventing others from working for him or causing them to leave his employ by fraud or misrepresentation or physical or moral intimidation or persuasion, with an intent to inflict an injury which causes loss. A conspiracy may, when accompanied by an overt act, create a liability, by reason of the fact that one or more conspirators may do an unlawful act which causes damage to another, by which all those engaged in the conspiracy for the accomplishment of the purpose for which the injury was done, and which was done in pursuance of the conspiracy, would be alike liable, whether actively engaged in causing the loss or not. For acts illegally done in pursuance of such conspiracy, and consequent loss, a liability may exist against all of the conspirators. Appellants, and those persons who refused to do appellee's work, had each a separate and independent right to unite with the organization known as the Chicago Laundrymen's Association, but they had no right, separately or in the aggregate, with others, to insist that the appellee should do so, or to insist

that appellee should make her scale of prices the same as that fixed by the association, and make her refusal to do this a pretext for destroying and breaking up her business. A combination by them to induce others not to deal with appellee or enter into contracts with her or do any further work for her was an actionable wrong.

Every man has a right, under the law, as between himself and others, to full freedom in disposing of his own labor or capital according to his own will, and any one who invades that right without lawful cause or justification commits a legal wrong, and, if followed by an injury caused in consequence thereof, the one whose right is thus invaded has a legal ground of action for such wrong. Damage inflicted by fraud or misrepresentation, or by the use of intimidation, obstruction or molestation, with malicious motives, is without excuse, and actionable. Competition in trade, business or occupation, though resulting in loss, will not be restricted or discouraged, whether concerning property or personal service. Lawful competition that may injure the business of another, even though successfully directed to driving that other out of business, is not actionable. Nor would competition of one set of men against another set, carried on for the purpose of gain, even to the extent of intending to drive from business that other set and actually accomplishing that result, be actionable unless there was actual malice. Malice, as here used, does not merely mean an intent to harm, but means an intent to do a wrongful harm and injury. An intent to do a wrongful harm and injury is unlawful, and if a wrongful act is done to the detriment of the right of another it is malicious, and an act maliciously done, with the intent and purpose of injuring another, is not lawful competition. In this case it is clear the evidence sustained the allegations of the plaintiff's declaration, and there is here no contention on the facts. The principles herein announced are sustained by the weight of authority in England and in this country. *Lumley v. Gye,* 2 E. & B. 216; *Blake v. Lanyon,* 6 T. R. 22; *Sykes v. Dixon,* 9 A. & E. 693; *Pilkington v. Scott,* 15 M. & W. 657; *Hartley v. Cummings,* 5 Com. B. 247; *Bowen v. Hall,* L. R. 6 Q. B. Div. 333; *Carew v. Rutherford,* 106 Mass. 1; *Walker v. Crowen,* 107 id. 555; *Chipley v. Atkinson,* 1 South Rep. 934; *Delz v. Winfree,* 165 West. Rep. 111; *Curran v. Galen,* 22 N. Y. Sup. 826; *Van Horn v. Van Horn,* 52 N. J. L. 284.

In *Mogul Steamship Co. v. McGregor, Gow & Co.* L. R. 15 Q. B. Div. 476, Lord Coleridge said: "It seems that a large number of important and rich ship owners joined together and have issued two circulars or documents to the different traders and

their agents with whom they had been in the habit of dealing in the tea and other trades in China, to the effect that if the persons whom that circular reached and was meant to affect should deal with the plaintiffs or plaintiffs' ship, they, the defendants, would deny them all the benefits, or at least a very large and substantial benefit, which had accrued to them in their dealing with the defendants; that if the persons to whom they addressed the circulars would deal exclusively with them they should have certain advantages at their hands. . . . It is conceivable that if such a conspiracy—because conspiracy undoubtedly it is—were proved in point of fact, were made out to be not the mere honest support of a defendant's trade, but the destruction of the plaintiff's trade and their consequent wrong as merchants, it would be an offense for which an indictment for conspiracy, would lie; . . . that the conspiracy to do the thing which has been called by the name of 'boycotting' is unlawful and an indictable offense, and if so, then a thing for which an action will lie. An action may well lie for that which is complained of here."

It is urged by appellants that they cannot be held liable for inducing certain persons named in the declaration to terminate their contractual relations with appellee, because their acts could not produce the injuries complained of without an independent force which was the act of the parties themselves, and these appellants, it is urged, cannot be held liable for an intervening cause of damage sufficient to cause the injury; and that the refusal of different persons to work for the appellee was sufficient, of itself, to occasion injury, for which the appellants cannot be held responsible. The first branch of this proposition has been disposed of by what we have heretofore said, and the authorities above cited. In *Lumley v. Gye, supra,* it was said: "He who maliciously procures a damage to another by a violation of his right ought to be made to indemnify." In *Bowen v. Hall, supra,* it was said: "Merely to persuade the person to break his contract may not be wrongful in law or in fact, but if the persuasion be used for the direct purpose of injuring the plaintiff . . . it is actionable, if injury ensues from it." The second branch of the proposition, in which it is urged that appellants could not produce the injuries complained of without the intervention of an independent force, presents the question whether the proximate cause of the injury is a question of fact. It has been settled by the adjudication of this state, so far as this question is here concerned, that in this state what was the cause of the injury, or the combination of causes producing it, is a question of fact. Whether the injury and damage sustained by

plaintiff resulted from the acts of the defendant or were the result of a new, independent factor for which appellants were not responsible, cannot be determined by the court as a question of law, unless the fact conceded or the proof be substantially all to that effect. (*Pullman Palace Car Co. v. Bluhm,* 109 Ill. 20; *City of Mt. Carmel v. Howell,* 137 id. 91; *Meyer v. Butterbrodt,* 146 id. 131.) The finding of the trial and Appellate Courts on this question is not subject to review in this court.

It is next insisted that the damages are excessive. This has so repeatedly been held to be an error which cannot be assigned in this court that citation of authority will be unnecessary.

What has been said in the discussion of the questions heretofore presented effectually disposes of all questions raised on giving, refusing and modifying instructions.

The judgment of the Appellate Court for the First District affirming the judgment of the circuit court of Cook county is affirmed.

§242. *The Protection of Contractual Interests Against Intervention by Strangers.*—The case amply illustrates the necessity in modern times of protecting one's contractual interests from interference by strangers. The courts have moved in this direction in the nineteenth century largely through the conception that contractual rights were a kind of property. It is at least true that they are just as important as many of the rights that have heretofore been dealt with as property. It is one of the jural postulates of our time that one's expectancy of fulfilment of agreements be generally realizable.

The great difficulty in this class of cases is connected with the theory of causation in torts. Where A induces B to break his contract with C, there is an intervening human agency (B) between the tort feasor's act and the damage resulting. This difficulty is overridden rather than met in the above case. As a matter of fact, the conception on which the difficulty is based is hardly psychologically true. A sharp contrast between free agents and totally unfree agents does not exist in life. As a matter of common sense, there is a direct line of causation between such acts as those described in the above case on the part of the Chicago Laundrymen's Association and the damage suffered by the plaintiff.

The case mentions boycotting and cites the leading case of the *Mogul Steamship Company v. McGregor.* The difficulty involved in the boycotting cases is that there is nothing unlawful about refusing to deal with a particular person, nor is there anything unlawful in inducing others to refuse to have dealings

with a person. The question raised, therefore, is to what extent will malice (which is defined as unlawful intent to injure another) make otherwise lawful acts unlawful? The law endeavors to classify all acts as lawful or unlawful. In doing so, it makes a rough approximation to the moral distinction between blameworthy and unblameworthy acts. Yet the approximation is so imperfect—at times very imperfect—that the law is forced to engraft exceptions on both types of acts. It protects the innocent by breaking down the recognized types of culpable conduct; and it charges the guilty by making inroads upon the corresponding recognized types of non-culpable (immune) conduct. Thus, in the case of the boycott, where the sole or primary object is to injure another and damage results, the law imposes liability.[1]

§243 *LAWRENCE v. FOX.*

Court of Appeals of New York, 1859. [20 *N. Y.* 268.]

[This case presents the much controverted question whether an agreement between A and B, whereby A agrees to pay a sum of money to C can be sued on by C, the beneficiary. On the basis of the legal conception of ''privity of contract'' the right of such beneficiaries to sue was long resisted in the courts. Gradually, however, by means of exceptions, the resistance was overcome. In the present case, C was not a gratuitous beneficiary but a ''creditor beneficiary'' and this case has long been the leading authority, at least as to the right of such beneficiaries.]

GRAY, J.: . . . In this case the defendant, upon ample consideration received from Holly, promised Holly to pay his debt to the plaintiff; the consideration received and the promise to Holly made it as plainly his duty to pay the plaintiff as if the money had been remitted to him for that purpose, and as well implied a promise to do so as if he had been made a trustee of property to be converted into cash with which to pay. The fact that a breach of the duty imposed in the one case may be visited, and justly, with more serious consequences than in the other, by no means disproves the payment to be a duty in both. The principle illustrated by the example so frequently quoted (which concisely states the case in hand) ''that a promise made to one for the benefit of another, he for whose benefit it is made

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[1]See Ames, "*How far an act may be a tort because of the wrongful motive of the actor.*" 18 Harvard Law Review 411, reprinted in *Lectures on Legal History,* 399. See also Isaacs, *Fault and Liability,* 31 Harvard Law Review, 954, 973.

may bring an action for its breach,'' has been applied to trust cases, not because it was exclusively applicable to those cases, but because it was a principle of law and as such applicable to those cases. It was also insisted that Holly could have discharged the defendant from his promise, though it was intended by both parties for the benefit of the plaintiff, and therefore the plaintiff was not entitled to maintain this suit for the recovery of a demand over which he had no control. It is enough that the plaintiff did not release the defendant from his promise, and whether he could or not is a question not now necessarily involved. . . .[1]

§244 *BLUNK v. DENNISON WATER-SUPPLY CO.*
Supreme Court of Ohio, 1905. [71 *O. S.* 250.]

SHAUCK, J.: Remembering that the case presented by the original petition is not affected by its argumentative averments, the question to be considered does not differ from that determined in the numerous cases given in the reporter's abstract of the briefs. They are nearly, if not entirely, in accord with the judgment of the circuit court in the present case. Those in which a different view of the subject has been taken will receive sufficient attention if, following the suggestion of counsel for the plaintiff, we give due consideration to the principles involved in the inquiry. Their reliance is upon the proposition that an agreement made on a valuable consideration by one person with another to perform an obligation to a third may be enforced by such third person in his own name, as was held by this court in *Crumbaugh et al. v. Kugler et al.*, 3 Ohio St., 544, and other cases following it. But an obligation to the inhabitants of a municipality as distinct from that to the municipality itself arising out of contracts of this character has been frequently asserted by the inhabitants and nearly as frequently denied by the courts. These cases proceed upon the familiar principle that contracts bind only the parties who have executed them and those who are in privity with them. The cases relied on by counsel for the plaintiff concede the principle stated, and they were supposed to be decided consistently with it. They are without exception cases in which a legal obligation rested upon the promisee in the contract sued upon towards the third person bringing the suit, and such obligation is indispensable to the application of the doctrine. The view upon which such obliga-

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[1][See Professor Corbin's note in 27 Yale Law J. 1008, reproduced in his edition of Anson on *Contracts*, 1919, p. 335. EDRS.]

tion is thought to meet the requirements of the rule as to privity, is thus expressed in *Vrooman v. Turner*, 69 N. Y., 280.

"A legal obligation or duty of the promisee to him (the plaintiff) will so connect him with the transaction as to be a substitute for any privity with the promisor, or the consideration of the promise, the obligation of the promisee furnishing an evidence of the intent of the latter to benefit him, and creating a privity by the substitution with the promisor. A mere stranger cannot intervene and claim by action the benefit of a contract between other parties."

That such legal obligation from the promisee to the plaintiff is wanting in the present case is made clear by *Wheeler v. Cincinnati*, 19 Ohio St., 20, where it is decided that the municipality is not liable to individuals for failure to furnish apparatus for extinguishing fires. If a stranger to a contract were held entitled to secure the benefits which might incidentally result to him from its performance, not only would an established rule of the law be violated, but parties entering into contracts could not determine the extent of their obligations nor the numbers of those to whom they might be incurred. The view of the subject urged on behalf of the plaintiff finds even less support in the reasons involved than it does in the decided cases.

Judgment affirmed.

DAVIS, PRICE, CREW AND SUMMERS, JJ., concur.

§245. *Who is "Creditor Beneficiary," a Question of Fact.*—This case represents the weight of authority on attempts of individual citizens to sue public service companies on contracts made between those companies and cities or other government units. Is the reasoning of the learned judge sound when he assimilates the case of such citizens to that of "a stranger to a contract [attempting] to secure the benefits which might incidentally result to him from its performance?" What other considerations are there to determine the question of who shall be permitted to sue in such a case? Can the citizen ignore the contract and win a recovery from the public service company on the basis of a tort (negligence) growing out of the contract?

PART III

THE ENFORCEMENT OF CONTRACTS, WITH SPECIAL REFERENCE TO THE RELATION OF DEBTOR AND CREDITOR

CHAPTER IX

THE ORDINARY MACHINERY PROVIDED BY THE LAW.

A. In General.

§246. *The Conduct of a Case in Court.*—The conducting of a case in court for the purpose of enforcing an obligation, even the mere collection of a debt, is too highly technical a matter to fall within the scope of the work of an ordinary business man or even of a professional credit man. Nevertheless, it is essential to understand the general nature of the mechanism set in motion when a claim is put into the hands of an attorney for collection by means of a suit. There are certain limits to the effectiveness of legal action wholly unconnected with the peculiarities of any particular legal system, and then again, there are such as grow out of more or less accidental rules peculiar to the Anglo-American system or are created by more or less deliberate legislation. These limits are vital factors that must be coped with in every credit problem. Again, something must be known of the nature of judicial proof, for the making and perpetuation of evidence in business is either fully accomplished or forever rendered impossible in many instances long before there is any thought of calling a lawyer into the case.

The steps in the simplest collection case would normally be these: 1. Bringing of the case and the parties into court; 2. Framing of an issue; 3. Hearing or trial; 4. Judgment; 5. Judicial review (in some cases); 6. Execution.

1. *Bringing of the Case and the Parties Into Court.*—Some form of summons is of course essential. To us it seems quite natural that the party complained of should be summoned by authority of the court to appear and answer or, on his failure

to answer within a specified time, to suffer judgment by default. This was not always so, however. In early law, courts were quite helpless to proceed against a stubborn opponent who refused to submit to the jurisdiction of the court. The situation was very much like that which prevails today in international law or in industrial disputes. Once the parties agree to arbitrate, there is not so much difficulty in discovering an acceptable principle of adjudication. It is beyond the scope of the present study to describe the roundabout process resorted to to overcome this difficulty in early law. For our purposes, it is enough to recognize in the needlessly formal mode of summoning an opponent to court by the service of process, at the hands of a sworn official, on the defendant in person or by leaving a copy at his place of residence, a relic of the days when the question of jurisdiction over the person was a vital one. In a few jurisdictions, attempts are being made to substitute the use of the mails, at least registered mail, and occasionally some even less formal method of calling a man to court. From a business point of view, it is of course desirable to do away with as much red tape as possible in these matters. Nevertheless, it is not desirable to make the matter of summoning to court so formless and irresponsible as to lead to the nuisance of idle litigation.

In most jurisdictions today, the filing of a complaint, petition, or declaration, as the first paper is variously called, is enough to set the machinery in motion and a writing called a "Præcipe" will cause the defendant, if he can be found within the jurisdiction of the court, to be summoned.

If the defendant cannot be found either actually or constructively within the jurisdiction of the court, methods are provided whereby his property found within the jurisdiction can be attached and subjected to the payment of his debts. In such cases the provisions of the statutes must be followed with reference to publicity, including, generally, advertising in newspapers, so as to enable the defendant to come in and protect his property if he wishes to do so.

2. *Framing of an Issue.*—It is absolutely essential that the particular point in dispute between parties be definitely ascer-

tained at some time in the course of the proceeding. According to the traditional system, known as common law pleading in England and America, the framing of an issue was accomplished by means of the pleadings; that is to say, the written or spoken allegations of the opposing sides as to what is admitted and what is denied of the allegations of their respective opponents. The theory of common law pleading is simple. After the first paper (the declaration) is filed by the plaintiff, the defendant must either deny (traverse) a single material allegation or confess the truth of the plaintiff's statements and plead new matter by way of avoidance; or he can demur—that is to say, admit the plaintiff's allegations for the sake of argument and, as a legal proposition, say, "What of it?" If the defendant brings in new matter by way of confession and avoidance, the plaintiff in turn can meet these new elements by means of a traverse, a confession and avoidance, or a demurrer; and so on. The result logically is to lead to a point where there is a direct denial of an opponent's allegation of fact or a difference of opinion as to the law. The mass of material that would otherwise be discussed is thus carried down to a single point for the determination of a jury, if the question be one of fact, or of a judge, if the question be one of law.

The fine-spun logic of this theory did not always meet the demands of common sense. Quite frequently it resulted in the trial of a man's theory of his case rather than in the trial of the merits of the case.[1] Consequently a great many inroads were made into the theories from time to time, permitting pleadings in the alternative or pleading by way of general denial so as to set in issue any and all material facts. Finally, in the nineteenth century, by statute in most states, the entire system of common law pleading has been revised so as to conform more nearly to the system that had been in use in courts of equity, and a single plan is adopted for procedure in all of the old types of actions at law and in equity as well. That is to say, rigid forms are done away with and parties are expected to state in ordinary, concise language and, in some jurisdictions, merely

[1] Isaacs, *Logic versus Common Sense in Pleading.* 16 Michigan Law Review, p. 589. *Cf.* §5, 6, *supra.*

in such language as will give due notice to an opponent, the nature of his claim or the ground of his defense. The task of framing the issue under these recent systems tends to be postponed until the hearing of the case. When amendments are freely allowed on the basis of the way the evidence actually turns or even in the absence of amendments, when the judge in his charge to the jury practically reframes the issue in the case. In any event it is just as essential as ever in the intelligent conduct of the case, though the penalties for blundering are not so severe, to frame the issue or issues accurately.[2]

3. *Hearing or Trial.*—Questions of law raised by demurrer, or sometimes simply by means of a motion, are argued to the court. Unless the parties have agreed upon a statement of facts, the decisions on such questions of law are generally not conclusive as to the rights of the parties, but simply feelers that enable them to re-shape their cases.

Questions of fact, on the other hand, in ordinary law cases, are generally tried before a jury. The jury, of course, may be waived and in many jurisdictions, if the amount in controversy is very small (under $20), a party is not entitled to demand a jury. The jury, as at present constituted in Anglo-American law, consists of twelve men (in some of the lower courts six) chosen more or less at random from among the disinterested citizens of the community to determine under oath and under instructions from the court on the basis of evidence presented in court questions of fact involved in litigation. There is a long and complicated history back of the jury system. At first it was an instrument whereby the Norman conquerors extracted information from members of a vicinage with reference to all kinds of matters of interest to the rulers. Later it became a means, as it is today, for the resolution of questions of fact in the royal courts, but with this difference: a jury was chosen from a particular neighborhood to give the opinion of that neighborhood. In other words, twelve sworn men were sworn as witnesses rather than as judges of fact. Finally, the reversal

[2]On the importance of choosing a proper theory of a case *cf.* §186, *supra*, and the case in the footnote to that section.

of their position became so complete than an opinion formed in advance on the part of a would-be juror was enough to disqualify him for serving on a jury.[3]

Under this modern type of jury, there has grown up the common law system of excluding and admitting evidence. In truth there are only three rules of evidence—though permutations of these three rules fill volumes and even encyclopedias on the law of evidence. In their simplest form, these rules are that evidence to be admissible must be Relevant, Competent, and Material. Relevancy is really a question of logic. Whatever tends to prove or disprove the proposition in issue according to the ordinary standards of human judgment is relevant. But not all relevant evidence is competent in a court of law. For example: if the question is whether a certain person has forged a certain signature, it might be relevant in the ordinary affairs of every day life to know that the same person has been guilty or even suspected of committing forgery, or, for that matter, any other crime involving dishonesty in the past. There are reasons, however, why this type of evidence cannot be considered in a court of law. The principal rules of competency have to do with the qualifications of witnesses, hearsay and the best evidence rule. In general, considerations that formerly disqualified witnesses now simply affect their credibility. The hearsay rule means that no evidence is competent unless the witness who presents it speaks of his first-hand knowledge. Mere repetition of what he heard some one else say who was speaking not under oath and without being subject to the precautionary measure of cross-examination, is inadmissible. There are, however, many exceptions to the hearsay rule. Among these exceptions are: the testimony of a witness on a former trial in relation to the same subject, if the witness is dead, insane, or for any other good reason cannot be brought into court; the dying declarations of a person conscious of impending death with reference to the manner in which his death was caused; certain declarations of deceased persons on questions of pedigree or of matters of public or general interest, including private boundaries; records con-

[3] *Cf.* §2, *supra.*

tained in public documents; entries and declarations against the interest of the party making them; entries in account books of parties to the litigation;[4] entries and declarations of third parties made in the regular course of duty or business;[5] utterances or statements (such as groans, grunts, or sighs) that are really outward manifestations of facts rather than statements about them; declarations which are a part of some fact or transaction rather than statements about them. It will be observed that some of these exceptions are not exceptions to the hearsay rule at all, but merely instances in which the repetition of that which another has said is first-hand and not second-hand evidence. Other cases, though conveniently classed as exceptions to the hearsay rule, really represent a type of evidence always admissible in court from a time antedating the formulation of the hearsay rule, for example, the use of public records. Others, such as the declaration against interest, constitute a class of genuine exceptions to the rule.

The so-called best evidence rule is simply a requirement that where, from the nature of the case, there must be a more authentic or more reliable type of evidence than that offered, the evidence offered should be rejected unless there is offered a satisfactory explanation of the absence of the better type of evidence. For example, in the case of a written contract, the testimony of one who has read the contract is not so good as the paper itself.

Evidence which is relevant and competent may still do more harm than good in the actual business of trying cases. That is to say, its probative force may be so remote that it tends merely to confuse the issue and clutter up the record with out-of-the-way matter. Unless there were some more or less arbitrary rule of immateriality, the wheels of justice would be clogged by A's attempt to prove that B's witnesses were unreliable, countered by B's attempt to prove that A's witnesses as to the character of B's were equally unreliable, and so on. The rule excluding remote and immaterial evidence must either be arbitrary or left

[4]Hence the importance of keeping regular account books.
[5]Where a reasonable system of bookkeeping is consistently carried out the law will take many of its peculiarities into consideration.

in large measure to the discretion of the court. The tendency in our state courts (where there is less judicial freedom than in the Federal courts) is, unfortunately, to pile up concrete rules as to what is and what is not too remote.

While these rules of evidence grew up originally to meet the exigencies of our jury system, they have extended themselves into the trial of cases without juries. In equity there was no jury and in general, under the codes where equity relief is asked for—that is to say, some kind of relief other than a mere money damage, trial is without a jury. Nevertheless, courts will govern themselves pretty largely by the common law rules of exclusion.

4. *Judgment.*—The decision of a jury (verdict, from the Lat. *verum dicere,* to declare the truth) or the decision of the judge is the basis for the final judgment or decree of the court. The judgment is ordinarily to the effect that A owes B a certain sum of money. It is not self-executory. The decree, on the other hand, is the order of a court of equity commanding that a certain thing be done or not done (injunction) under penalty of being in contempt of court. The decree is practically self-executory because failure to comply with it carries with it a summary penalty.[6]

5. *Judicial Review.*—For a party who is not satisfied with the judgment, there is in the Anglo-American system generally a provision for judicial review. There are in general two types of review: appeal and error proceedings. The appeal comes to us from equity. It is, strictly speaking, a review of a decision of fact. In law, on the other hand, where the decision of fact is by twelve men, the review by a court would be inconsistent with the nature of the jury system. Error proceedings are, however, open in such a case; that is to say, a result may be reversed or a case remanded because of mistakes of law that have been made in the trial, whether in the admission or rejection of evidence or in giving an erroneous instruction to the jury. In such a case, it is also possible, if the attention of the court is called to its error before its final judgment is entered on

[6] *Cf.* §4, *supra.*

a verdict, to make a motion for a new trial. In some jurisdictions, such motions are made as a matter of course and, almost as a matter of course, turned down. Bonds securing the payment of the judgment or costs or performance of the decree are required from a party asking for review.

6. *Execution.*—After a judgment is rendered, if it is not paid, some arrangement must be made whereby the law can coerce the payment. In primitive law, this coercion was left largely to self-help. In course of time one kind after another of the property of the defendant was made subject to the payment of his debts. Imprisonment of the person for debt, once common, is practically obsolete. As matters stand now in practically all jurisdictions outside of New England, a judgment becomes a lien upon all of one's real estate in the jurisdiction in which the judgment is rendered, and although in most states the lien attaches either at the time judgment is rendered or at the time it is docketed, in some states it dates back to the first day of the term in which it is rendered. For this reason it is important to know in the granting of credit whether the applicant possesses any real estate. Furthermore, it is important when real estate is purchased or when money is lent on it to know whether there are any judgments outstanding against the owner or whether there is any pending litigation that may ripen into a judgment before the expiration of the present term of court. In the case of personal property (that is to say, movable goods and interests in land of smaller duration than a life) the lien of a judgment does not attach until the property is seized under a levy of execution by the proper officer on order of the court, for the purpose of enforcing the judgment. The real estate or personal property so taken is advertised for public sale, sold, and the proceeds are used to pay the costs of the litigation and to satisfy the judgment and the surplus, if any, is returned to the defendant.

Intangible assets, such as the right to collect a debt from another, may also be taken in execution by serving an official notice on the judgment debtor's debtor. This process is usually known as "garnishment." Equitable interests, for instance, that of the beneficiary of a trust, can generally be reached only by

resort to a court having equity powers by the so-called "creditor's bill," "trustee process," or "bill to reach and apply."

In certain cases where there is danger that the debtor's property will be concealed or removed or destroyed before execution (and in some of the New England states as an ordinary incident to the summons) authority is given by special statute to cause the property to be "attached," either at the time of the filing of the suit or at any time thereafter while the case is pending. In such cases a bond is generally required from the party asking for attachment, because it cannot be known in advance whether he will be entitled to execution or not and he must agree to be responsible for any damage caused by an attachment that turns out to be improper. In some cases, where the defendant cannot be found though his property is within the jurisdiction of a court, the property may be attached and the claim may be prosecuted *quasi in rem.* The judgment in such case, unless the owner of the property appears to defend the case, will bind the defendant only to the extent of the property attached. If for any reason the attachment is irregular and must be dismissed, no judgment can be rendered, and if the property is not adequate to pay the entire claim, no deficiency judgment can be rendered in the suit. The rights of strangers in the property are not affected by the proceedings in court. In other words, the so-called judgment, *quasi in rem,* has all the limitations of a judgment *in personam,* as well as the limitations of a judgment *in rem,* such as those rendered in the admiralty courts with reference to ships, regardless of the presence or absence of the owners. It cannot affect the rights of third parties in the particular thing as does the judgment *in rem,* nor can it be considered as *res adjudicata,* so far as the defendant personally is concerned, as can the ordinary judgment *in personam.*

Certain limits have been set by statute upon the right to take one's property in execution for the payment of his debts.

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[7]For an interesting and successful attempt "to harmonize, as far as possible, the various statutes and doctrines which are scattered through the body of our law so as to demonstrate the system afforded by our jurisprudence for the realization of debts out of the debtor's property," see G. Glenn, *The Rights and Remedies of Creditors Respecting Their Debtor's Property*, Boston, 1915.

Personal exemptions, covering the tools of the mechanic, the instruments of the physician, the books of the lawyer, and the like, and homestead exemptions covering, in some states, a homestead of unlimited value, but in most states an interest in a homestead of a limited amount, are given to the heads of households because of the state's interest in protecting the family as an institution against the casualties of business. In some of the western states, this theory has been stretched in a manner to make their undeveloped domains a haven for debtors unable or unwilling to pay their debts. Except when so abused, these laws serve the social purpose of shifting part of the risk of engaging in a business from the shoulders of the debtor to his creditor and indirectly to the entire business system of the country.

The cumbersomeness of the Anglo-American system of procedure and the uncertainty and limitations attendant upon it have forced business men to seek other means of enforcing their claims against one another than those provided by the general law.[8] In the early days, when the system was even more cumbersome and ineffective than it is today, merchants used to demand and receive promises of speedy justice *secundum legem mercatoriam*. But with the disappearance of the separate courts of the merchants, it became necessary to rely upon special contractual arrangements for the safeguarding of credit. Hence the use of mortgages (real and personal), pledges, suretyship, guaranty, indemnity contracts, and the numerous special arrangements described in the following pages. (*Cf.* §270 ff. *infra.*) Possessory liens deserve special mention, as coming halfway between the provisions of the ordinary law and contractual stipulations for the safeguarding of credit. For many centuries, the lien existed as a kind of substitute for court procedure to exert pressure on the debtor by the mere detention of

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[8]As to arbitration see §195, *supra*. See also Smith, *Justice and the Poor*, 1919, p. 68 ff. (The whole book is illuminating on the general subject of the cumbersomeness of legal procedure, though it is dealt with on the basis of the needs of "the poor," rather than the needs of business. But after all, are the fundamental needs so very different?) See also *Commercial Arbitration*, Report of the Special Committee on Arbitration of the New York Chamber of Commerce (1911); Cohen, *Commercial Arbitration and the Law*, 1918.

his chattel, in certain cases for which no action had been provided by the law. Gradually the law provided actions in most of these cases and the liens remained undisturbed, as an additional remedy. In course of time, courts began to look upon these liens as based, in some instances at least, upon contract. Finally, in the nineteenth century, under the influence of the general tendency to reduce as much of the law as possible to the principle of contract, courts began to state that all possessory liens were based on contract, express or implied, and that, in the case of implied liens, the terms were sometimes to be gathered from custom or usage and sometimes from positive provisions of the law. The so-called mechanics' lien and material men's liens are statutory creations based on the analogy of possessory liens, calculated to give those who do work on ships and buildings or in mines or who furnish material for such work, an additional protection through the simple expedient of filing a sworn claim in a public office, which serves as a notice to all the world of their interest in the property.

In addition an equitable extention of the possessory lien idea has developed in the law of sales, the right of stoppage *in transitu,* under the extraordinary conditions of the insolvency of the buyer, even though technically delivery to the carrier has constituted a surrender of possession inconsistent with the existence of a possessory lien. *Cf.* the provisions in the Uniform Sales Act, §§54-62.

§247. *Types of Legal Remedies.*—The methods used by the law for exerting pressure are of three kinds: prevention, punishment and restitution. Preventive justice, like preventive medicine, is in its infancy. There have long been cases, of course, in which courts would, by injunction, or even receiverships, interfere to prevent a threatened irreparable injury. There are also instances of a more modern type in which the taking of control of a situation by public officers is provided for as a previsionary measure to prevent the necessity of later remedial measures. In a sense, too, the police system represents the administration of a kind of preventive justice. But, in general, our law has grown up by means of complaints and the law

has not been inclined to permit a man to complain before he was hurt. Bentham has compared the judicial method of administering and building up the law to the process of training a dog by waiting until he does that which he is not supposed to do and then beating him for it. On the other hand, the establishment of departments of the government whose duty it is to study commercial conditions, to supervise certain types of business, such as railroad commissions, insurance commissions, bank commissions and the like, with power to define the conditions under which business shall be done, and thus to prevent disastrous failures, discriminations, and the like, is in its experimental stage. Licensing is coming to be used more and more as an instrument for the administration of preventive justice in business affairs.

The second method, punishment, is one of the oldest methods of the law. Strictly speaking, it belongs to the realm of criminal law. Nevertheless, in suits between parties, "exemplary" or "punitive" damages or "smart money" are allowed in certain classes of tort cases and in one class of contract case, the breach of promise to marry, as a relic of the time when tort law and criminal law were not clearly differentiated. There are, besides, special statutes under which the recovery of a penalty is allowed in a civil action, either in whole or in part, for the use of the person bringing the action under such statutes—for example, in the action for money won in gambling.

Restitution is of two kinds: the so-called specific restitution, and the substituted money damage. Specific restitution, or the specific performance of a duty, so far as that is possible when its proper time is passed, whether growing out of the contract or imposed by law, is, as we have seen, limited to equity courts and allowed only in extraordinary cases—cases in which a money damage is not deemed to be adequate.[1] There is one kind of specific restitution, or rather, recognition of a continuation of a *status quo,* sometimes spoken of as the sanction of nullity. Thus, if the law provides a particular manner in which a thing

[1]There are two apparent exceptions; through replevin the law can give one back his specific chattel, if it can be found, and through ejectment it can restore to him the possession of his land.

must be done as in the Statute of Frauds, it enforces its requirement by refusing to recognize the act as having been done at all, unless done in that particular way.

The substituted money damage represents in Anglo-American law the normal remedy in ordinary cases. It is well to bear in mind that this is not true in systems based on the Roman law, nor was it true in very early English law. Furthermore, it must be remembered that, in many cases, the granting of a money damage is frequently a specific restitution of that to which the plaintiff was entitled, as in the case where the suit is brought on a debt. In ordinary parlance, however, no distinction is made between money awarded to fulfill an obligation and money awarded for its non-fulfillment—it is all "damages." The study of the measure of damages, therefore, in ordinary business cases is tantamount to a consideration of what the law will do for a plaintiff in a particular case. By special contract, however, it is frequently attempted to control in advance the measure of damages. In case of a breach, to what extent can this be done? To what extent are the rules standardized by law?

B. Damages.

§248 *GEISER MFG. CO. v. KROGMAN.*

Supreme Court of Iowa, 1900. [111 *Iowa* 503.]

DEEMER, J.: . . . That an agreement not to claim damages is valid where no question of public policy is involved, see *Griswold v. Railway Co.,* 90 Iowa 265; *Richmond v. Railroad Co.,* 26 Iowa 191; Sutherland on *Damages* (2d ed. §6; *Lee v. Tillotson,* 24 Wend. 337. The maxim, "*Modus et conventio vincunt legem*" applies where no question of public policy or fraud is involved. Where no rule of law or principle of public policy is involved the parties may, by contract, make a law for themselves . . .

§249 *ADAMS EXPRESS COMPANY v. CRONINGER.*

Supreme Court of the United States, 1913. [226 *U. S.* 491.]

This was an action in the Circuit Court of Kenton County, Kentucky, against the Express Company to recover the full

market value of a small package containing a diamond ring which was delivered by the plaintiff below to the Express Company at its office in Cincinnati, Ohio, consigned to J. W. Clendenning at Augusta, Georgia. The package was never delivered.

The Express Company made defense by answer. The plaintiff demurred to the answer as not containing a defense, which demurrer was sustained. The Company declined to further plead, whereupon the Circuit Court gave judgment for the sum of $137.52, being the full value of the ring and interest. A writ of error was sued out from this court to the Circuit Court of Kenton County, that being the highest court of the state in which a decision could be had.

The answer and accompanying exhibit were in substance as follows:

That the defendant was an express company engaged in interstate commerce within the provisions of the act of Congress of June 29, 1906; that in obedience to that act it had duly filed with the Interstate Commerce Commission schedules showing its rates and charges from Cincinnati to Augusta, Georgia, which schedules showed that its rates and charges, when the value of the property to be carried was in excess of fifty dollars, were graduated reasonably, according to the value, and that the lawful rate upon the package of the plaintiff from Cincinnati to Augusta was twenty-five cents if the value was fifty dollars or less, and was fifty-five cents if the value was one hundred and twenty-five dollars.

It is averred that the plaintiff knew that the charges upon the package shipped were based upon the value of the shipment, and that it (the defendant) required that the value should be declared by the shipper, and that if he did not disclose and declare the value when he delivered the shipment to it at Cincinnati for transportation to Augusta, the rate charged would be based upon a valuation of fifty dollars. It is then alleged that the package so delivered was sealed and that defendant did not know the contents or value, and that if it had it would not have received it for carriage for less than the lawful published rate of fifty-five cents. The receipt or bill of lading issued shows no value, but contains a stipulation in these words:

"In consideration of the rate charged for carrying said property, which is regulated by the value thereof and is based upon a valuation of not exceeding fifty dollars unless a greater value is declared, the shipper agrees that the value of said property is not more than fifty dollars, unless a greater value is

stated herein, and that the company shall not be liable in any event for more than the value so stated, nor for more than fifty dollars if no value is stated herein."

Mr. Justice LURTON, after making the foregoing statement, delivered the opinion of the court . . .

The original Interstate Commerce Act of February 4, 1887, 24 Stat. 379, c. 104, was extensively amended by the act of June 29, 1906, 34 Stat. 584, c. 3591. We may pass by many of the changes and amendments made by the latter act as not decisive, and come at once to the far more important amendment made in §20, an amendment bearing directly upon the carrier's liability or obligation under interstate contracts of shipment, and generally referred to as the Carmack amendment. For convenience of reference, it is set out in the margin.[1]

This amendment came under consideration in *Atlantic Coast Line v. Riverside Mills*, 219 U. S. 186, but the opinion and judgment was confined to that provision of the act which made the initial carrier liable for a loss upon the line of a connecting carrier, the property having been received under a bill of lading which confined the liability of the initial carrier to loss occurring upon its own line.

The significant and dominating features of that amendment are these:

First: It affirmatively requires the initial carrier to issue "a receipt or bill of lading therefor," when it receives "property for transportation from a point in one state to a point in another."

Second: Such initial carrier is made "liable to the lawful

[1]That any common carrier railroad or transportation company receiving property for transportation from a point in one state to a point in another state shall issue a receipt or bill of lading therefor and shall be liable to the lawful holder thereof for any loss, damage, or injury to such property caused by it or by any common carrier, railroad, or transportation company to which such property may be delivered, or over whose line or lines such property may pass, and no contract, receipt, rule or regulation shall exempt such common carrier, railroad, or transportation company from the liability hereby imposed: *Provided*, That nothing in this section shall deprive any holder of such receipt or bill of lading of any remedy or right of action which he has under existing law.

That the common carrier, railroad or transportation company issuing such receipt or bill of lading shall be entitled to recover from the common carrier, railroad or transportation company on whose line the loss, damage, or injury shall have been sustained, the amount of such loss, damage, or injury, as it may be required to pay to the owners of such property, as may be evidenced by any receipt, judgment, or transcript thereof.

holder thereof for any loss, damage, or injury to such property caused by it.''

Third: It is also made liable for any loss, damage, or injury to such property caused by ''any common carrier, railroad or transportation company to which such property may be delivered or over whose line or lines such property may pass.''

Fourth: It affirmatively declares that ''no contract, receipt, rule or regulation shall exempt such common carrier, railroad, or transportation company from the liability hereby imposed.''

Prior to that amendment the rule of carriers' liability, for an interstate shipment of property, as enforced in both Federal and state courts, was either that of the general common law as declared by this court and enforced in the Federal courts throughout the United States, *Hart v. Pennsylvania Railroad,* 112 U. S. 331; or that determined by the supposed public policy of a particular state, *Pennsylvania Railroad v. Hughes,* 191 U. S. 477; or that prescribed by statute law of a particular state, *Chicago, etc., Railroad v. Solan,* 169 U. S. 133.

Neither uniformity of obligation nor of liability was possible until Congress should deal with the subject. The situation was well depicted by the Supreme Court of Georgia in *Southern Pacific Co. v. Crenshaw,* 5 Ga. App. 675, 687, 63 S. E. Rep. 865, where that court said:

''Some states allowed carriers to exempt themselves from all or a part of the common law liability by rule, regulation, or contract; others did not; the Federal courts sitting in the various states were following the local rule, a carrier being held liable in one court when under the same state of facts he would be exempt from liability in another; hence this branch of interstate commerce was being subjected to such a diversity of legislative and judicial holding that it was practically impossible for a shipper engaged in a business that extended beyond the confines of his own state, or for a carrier whose lines were extensive, to know without considerable investigation and trouble, and even then oftentimes with but little certainty, what would be the carrier's actual responsibility as to goods delivered to it for transportation from one state to another. The congressional action has made an end to this diversity; for the national law is paramount and supersedes all state laws as to the rights and liabilities and exemptions created by such transactions. This was doubtless the purpose of the law; and this purpose will be effectuated, and not impaired or destroyed by the state courts' obeying and enforcing the provisions of the Federal statute

where applicable to the fact in such cases as shall come before them."

That the legislation supersedes all the regulations and policies of a particular state upon the same subject results from its general character. It embraces the subject of the liability of the carrier under a bill of lading which he must issue and limits his power to exempt himself by rule, regulation or contract. Almost every detail of the subject is covered so completely that there can be no rational doubt but that Congress intended to take possession of the subject and supersede all state regulation with reference to it. Only the silence of Congress authorized the exercise of the police power of the state upon the subject of such contracts. But when Congress acted in such a way as to manifest a purpose to exercise its conceded authority, the regulating power of the state ceased to exist. *Northern Pacific Railway v. State of Washington,* 222 U. S. 370; *Southern Railway v. Reid,* 222 U. S. 424; *Mondou v. Railroad,* 223 U. S. 1 . . .

We come now to the question of the validity of the provision in the receipt or bill of lading limiting liability to the agreed value of fifty dollars, as shown therein. This limiting clause is in these words:

"In consideration of the rate charged for carrying said property, which is regulated by the value thereof and is based upon a valuation of not exceeding fifty dollars unless a greater value is declared, the shipper agrees that the value of said property is not more than fifty dollars, unless a greater value is stated herein, and that the company shall not be liable in any event for more than the value so stated, nor for more than fifty dollars if no value is stated herein."

The answer states that the schedules which the express company had filed with the Interstate Commerce Commission showed rates based upon valuations; and that the lawful and established rate for such a shipment as that made by the plaintiff from Cincinnati to Augusta, having a value not in excess of fifty dollars, was twenty-five cents, while for the same package if its value had been declared to be one hundred and twenty-five dollars, the amount for which the plaintiff sues as the actual value, the lawful charge according to the rate filed and published would have been fifty-five cents. It is further averred that the package was sealed, and its contents and actual value unknown to the defendant's agent.

That no inquiry was made as to the actual value is not vital to the fairness of the agreement in this case. The receipt which was accepted showed that the charge made was based upon a

valuation of fifty dollars unless a greater value should be stated therein. The knowledge of the shipper that the rate was based upon the value is to be presumed from the terms of the bill of lading and of the published schedules filed with the Commission. That presumption is strengthened by the fact that across the top of this bill of lading there was this statement in bold type, "This Company's charge is based upon the value of the property, which must be declared by the shipper."

That a common carrier cannot exempt himself from liability for his own negligence or that of his servants is elementary. *York Mfg. Co. v. Illinois Central Railroad,* 3 Wall. 107; *Railroad Company v. Lockwood,* 17 Wall. 357; *Bank of Kentucky v. Adams Express Company,* 93 U. S. 174; *Hart v. Pennsyvlania Railroad,* 112 U. S. 331, 338. The rule of the common law did not limit his liability to loss and damage due to his own negligence, or that of his servants. That rule went beyond this and he was liable for any loss or damage which resulted from human agency, or any cause not the act of God or the public enemy. But the rigor of this liability might be modified through any fair, reasonable and just agreement with the shipper which did not include exemption against the negligence of the carrier or his servants. The inherent right to receive a compensation commensurate with the risk involved the right to protect himself from fraud and imposition by reasonable rules and regulations, and the right to agree upon a rate proportionate to the value of the property transported.

It has therefore become an established rule of the common law as declared by this court in many cases that such a carrier may by a fair, open, just and reasonable agreement limit the amount recoverable by a shipper in case of loss or damage to an agreed value made for the purpose of obtaining the lower of two or more rates of charges proportioned to the amount of the risk. *York Mfg. Co. v. Railroad,* 3 Wall. 107; *Railroad v. Lockwood,* 17 Wall. 357; *Hart v. Pennsylvania Railroad,* cited above; *Phoenix Ins. Co. v. Erie & W. Trans. Co.,* 117 U. S. 312, 322; *Steam Co. v. Phoenix Ins. Co.,* 129 U. S. 397, 442; *New York L. E. & W. Ry. v. Estill,* 147 U. S. 591, 619; *Primrose v. W. U. Tel. Co.,* 154 U. S. 1, 15; *Chicago, etc., Ry. v. Solan,* 169 U. S. 133, 135; *Calderon v. Atlas Steamship Co.,* 170 U. S. 272, 278; *Pennsylvania Railroad v. Hughes,* 191 U. S. 477, 485.

That such a carrier might fix his charges somewhat in proportion to the value of the property is quite as reasonable and just as a rate measured by the character of the shipment. The principle is that the charge should bear some reasonable relation to the responsibility, and that the care to be exercised shall

be in some degree measured by the bulk, weight, character and value of the property carried.

Neither is it conformable to plain principles of justice that a shipper may understate the value of his property for the purpose of reducing the rate, and then recover a larger value in case of loss. Nor does a limitation based upon an agreed value for the purpose of adjusting the rate conflict with any sound principle of public policy. The reason for the legality of such agreements is well stated in *Hart v. Pennsylvania Rairload,* cited above, where it is said (p. 340):

"The limitation as to value has no tendency to exempt from liability for negligence. It does not induce want of care. It exacts from the carrier the measure of care due to the value agreed on. The carrier is bound to respond in that value for negligence. The compensation for carriage is based on that value. The shipper is estopped from saying that the value is greater. The articles have no greater value, for the purposes of the contract of transportation, between the parties to that contract. The carrier must respond for negligence up to that value. It is just and reasonable that such a contract, fairly entered into, and where there is no deceit practiced on the shipper, should be upheld. There is no violation of public policy. On the contrary, it would be unjust and unreasonable, and would be repugnant to the soundest principles of fair dealing and of the freedom of contracting, and thus in conflict with public policy, if a shipper should be allowed to reap the benefit of the contract if there is no loss, and to repudiate it in case of loss."

The statutory liability, aside from responsibility for the default of a connecting carrier in the route, is not beyond the liability imposed by the common law as that body of law applicable to carriers has been interpreted by this court as well as many courts of the states. *Greenwald v. Barrett,* 199 N. Y. 170, 175; *Bernard v. Adams Express Co.,* 205 Massachusetts 254, 259. The exemption forbidden is, as stated in the case last cited, "a statutory declaration that a contract of exemption from liability for negligence is against public policy and void." This is no more than this court, as well as other courts administering the same general common law, have many times declared. In the same case, just such a stipulation as that here involved was upheld, the court saying (p. 259):

"But such a contract as we are considering in this case is not an exemption from liability for negligence in the management of property, within the meaning of the statute. It is a contract as to what the property is, in reference to its value.

The purpose of it is not to change the nature of the undertaking of the common carrier, or limit his obligation in the care and management of that which is entrusted to him. It is to describe and define the subject-matter of the contract, so far as the parties care to define it, for the purpose of showing of what value that is which comes into the carrier's possession, and for which he must account in the performance of his duty as a carrier. It is not in any proper sense a contract exempting him from liability for the loss, damage or injury to the property, as the shipper describes it in stating its value for the purpose of determining for what the carrier shall be accountable upon his undertaking, and what price the shipper shall pay for the service and for the risk of loss which the carrier assumes."

In *Greenwald v. Barrett,* cited above, the same conclusion was reached as to the nature of the liability imposed and the purport of the exemption forbidden, the court, among other things, saying:

"The language of the enactment does not disclose any intent to abrogate the right of common carriers to regulate their charges for carriage by the value of the goods or to agree with the shipper upon a valuation of the property carried. It has been the uniform practice of transportation companies in this country to make their charges dependent upon the value of the property carried; and the propriety of this practice and the legality of contracts signed by the shipper agreeing upon a valuation of the property were distinctly upheld by the Supreme Court of the United States in *Hart v. Penn. R. R. Co.,* 112 U. S. 331, 341."

To the same effect are the cases of *Travis v. Wells, Fargo Co.,* 79 N. J. L. 83; *Fielder v. Adams Express Co.,* 69 W. Va. 138; S. C., 71 S. E. Rep. 99; *Larsen v. Oregon Short Line,* 38 Utah, 130; S. C., 110 Pac. Rep. 983. See also, *Atkinson v. New York Transfer Co.,* 76 N. J. L. 608, as to the general rule.

That a carrier rate may be graduated by value and that a stipulation limiting recovery to an agreed value made to adjust the rate is recognized by the Interstate Commerce Commission, see 13 I. C. Rep. 550.

We therefore reach the conclusion that the provision of the act forbidding exemptions from liability imposed by the act is not violated by the contract here in question.

The demurrer to the answer of the defendant below should have been overruled.

For this reason the judgment is reversed, with direction to

overrule the demurrer, and for such further proceedings as are not inconsistent with this opinion.[2]

§250 *CURTIS v. VAN BERGH.*

Court of Appeals of New York, 1899. [161 *N. Y.* 47.]

VANN, J.: The question presented by this appeal is whether the sum which the plaintiff's assignor promised to pay the defendants for each day's delay in completing the building, after expiration of the period stipulated, is in the nature of a penalty or of liquidated damages. This question depends upon the intention of the parties, which is to be gathered from the language used in making the contract, read in the light of the circumstances surrounding them at the time. (*Little v. Banks,* 85 N. Y. 258, 266; *Kemp v. Knickerbocker Ice Co.,* 69 N. Y. 45, 58; *Colwell v. Lawrence,* 38 N. Y. 71, 74.) The words of the contract are that the sum of fifty dollars shall be paid by the plaintiff's assignor to the defendants for each day, after the date named for performance, "as fixed, settled and liquidated damages" which the defendants "will sustain by reason of the failure . . . to complete said building" within the time specified.

If this language is given its ordinary meaning the parties have not only defined the sum promised to be paid, as liquidated damages, but have expressly covenanted that it is the amount of damages, which the defendants would sustain in consequence of the delay, thus limiting recovery to the sum named, even if the actual damages should greatly exceed it.

The plaintiff, however, contends that the language of the agreement is not conclusive, and that these words should not be given their ordinary meaning, because the *per diem* payment is so excessive as to shock one's sense of justice and to warrant the inference that the parties could not have intended what they said, because it would be unreasonable. It is insisted that as the rent reserved was but $5.75 per day, the sum of fifty dollars for each day's delay is so out of proportion to the probable loss, as to bring the contract within that class of cases which hold that where the sum agreed to be paid is so great as to be unconscionable it will be regarded as a penalty, even if the parties have expressly declared their intention to be otherwise. (*Kemble v. Farren,* 6 Bing. 141; *Jackson v. Baker,* 2 Edw. Ch. 471; *Spencer v. Tilden,* 5 Cow. 144; *Niver v. Rossman,* 18 Barb. 50; *Mott v. Mott,* 11 Barb. 134; *Beale v. Hayes,* 5 Sandf. 640.)

[2] *Cf. Pierce Co. v. Wells, Fargo & Co.* (1915), 236 U. S. 278; *Boston, & Maine Railroad v. Hooker* (1914), 223 U. S. 97.

These authorities show that the courts have struggled hard against the apparent intention of the parties, in order to relieve the one in default from an improvident bargain. It is, however, the law of this state, as settled by this court, that where the language used is clear and explicit to that effect, the amount is to be deemed liquidated damages when the actual damages contemplated at the time the agreement was made "are in their nature uncertain and unascertainable with exactness, and may be dependent upon extrinsic considerations and circumstances, and the amount is not, on the face of the contract, out of all proportion to the probable loss." (*Ward v. Hudson River Building Co.,* 125 N. Y. 230; *Little v. Banks,* 85 N. Y. 258; *Kemp v. Knickerbocker Ice Co.,* 69 N. Y. 45, 57; *Clement v. Cash,* 21 N. Y. 253; *Baglie v. Peddie,* 5 Sandf. 192; S. C., 16 N. Y. 469; *Dunlop v. Gregory,* 10 N. Y. 241; *Cotheal v. Talmage,* 9 N. Y. 551.)

We thus reach the ultimate question, whether the damages within the contemplation of the parties when they made the contract in question are so uncertain as to be difficult of ascertainment, and if so, whether they are so grossly excessive as to be out of all proportion to the probable loss?

In making said contract the defendants provided for the lease of a building, to be erected, when there was less than six months' time within which to complete it, and they needed protection from the consequences of failure. They were engaged in a growing and profitable manufacturing business, which required more room and additional machinery. It was necessary to have the new building ready when their old lease expired, or their business would be seriously interrupted, and they would have no place to put either their new or their old machinery. Moreover, they could not manufacture goods for the fall and holiday trade, and they would be subject to summary ejectment from their old quarters for holding over after expiration of their term. It was doubtful whether, at midsummer, they could secure another place, temporarily, and if they could, it would compel them to move twice, at an increased expense and loss of time. Both parties knew that the failure to have the building ready on time would naturally result in the loss of business, and either in the temporary occupation of another building or a forcible removal through legal process. These elements of damage, which were necessarily within the contemplation of the parties, as reasonable men, when they made the contract, are uncertain, hard to ascertain with exactness and dependent upon extrinsic circumstances and considerations. Who can tell the loss to a large manufacturing business caused by closing the works in

a busy season, by the removal of such a business to temporary quarters, or summary dispossession at the hands of an officer? Who can estimate the injury to a manufacturing plant under such circumstances? What is more difficult to prove than loss of profits or damages to a business? What pecuniary standard is there to measure them by? (*Little v. Banks, supra.*) How can the amount be fixed, except by agreement? The damages, under the facts before us, are necessarily hard to establish with exactness, or otherwise, yet they may be so serious as to render it desirable to have the amount agreed upon in advance. The parties themselves can "come to a more satisfactory conclusion as to the damages than would be possible for a jury." (*Jones v. Binford,* 74 Me. 445.) This is, therefore, one of those cases where it must be presumed that the parties stipulated for the payment of a fixed sum of money absolutely, "from the difficulty of ascertaining any exact amount of damages which would be sustained by a breach of the agreement." (*Chase v. Allen,* 13 Gray 42.)

Is the sum agreed upon out of all proportion to the probable loss under the circumstances known to the parties when the agreement was made? Is it so disproportionate that one "would start at the mere mention of it," which is the test laid down in *Cotheal v. Talmage* (*supra*)? Of course the parties did not contemplate a long delay in completing the building or neither of them would have entered into the contract at all. We cannot say, as matter of law, the fifty dollars a day for the absolute suspension of a prosperous manufacturing business, for a few days, at the busiest season of the year, accompanied by a temporary removal to other quarters, or a forcible removal to the street, is so excessive as to shock one's sense of justice. It is less in proportion to the actual damages than the amounts sustained in several of the cases cited. Indeed, the actual damages might exceed it and the covenant thus prove a protection to the one in default.

We think the learned trial judge erred in directing a verdict for the plaintiff, and that the judgment below should be reversed and a new trial granted, with costs to abide the event.

All concur.

Judgment reversed, etc.

§251 *ORESTER v. DAYTON RUBBER MFG. CO.*

Court of Appeals of New York, 1920. [228 *N. Y.* 134.]

ANDREWS, J.: It seems that motor tires are made by various manufacturers and sold under different trade names. The

defendant makes what is known as the "Dayton pneumatic tire." Apparently it had never been introduced in Syracuse. For the purpose, therefore, of creating a demand for it and of distributing it through authorized dealers, the defendant agreed to manufacture, sell, and deliver to the plaintiff such tires as he might require at a reduction from its list prices as they might be fixed from time to time and further agreed that the plaintiff should have the sole right to distribute and sell these tires in Onondaga and some neighboring counties. In return he was to "aggressively push" the sale, to provide showrooms, to carry in stock a sufficient supply to meet the trade requirements, and to sell only in the territory allotted to him.

Under the contract some 200 tires were received and sold by the plaintiff, both at wholesale and retail. He also fulfilled all the obligations imposed upon him. Yet the contract was broken by the defendant. It refused to supply 1,000 tires which he had ordered. The question before us is as to the proper measure of damages under such circumstances.

The jury was instructed that this measure was the difference between the market value of these tires in Syracuse and the price fixed in the contract. It was told further that because of the plaintiff's sales there was such a market value. In effect, the jury was permitted to award as damages the gross profits which the plaintiff might have made had he sold the whole 1,000 tires at the prices he had fixed.

For a wrong, the law's ideal, not always realized, is compensation, neither more nor less. Theoretically the loss to an injured party because of a broken contract is its value to him. Yet this rule may not always be safely applied. He may have in mind or claim that he had in mind some special object which would make the contract of extraordinary value. It is well to avoid temptation. It is well to have some theory applicable to the majority of cases. The rule is therefore limited. As such value, for such loss, he may recover as damages only those that would naturally arise from the breach itself, or those that might reasonably be supposed to have been contemplated by the parties when the contract was made. True, this is an arbitrary rule. By it full justice is not always done. But it has seemed a politic one.

Further, the methods by which the result is reached are often standardized. In the case of sales, where the articles may be purchased in the market, the value of the contract to the purchaser is the difference between the price at which in like quantities they may be bought at the time and place of delivery and the price which he would have had to pay under the

contract. This rule assumes, however, the possibility of such a purchase in the market. Then the injured party may obtain the articles, but at a greater price. If this is made good, he is compensated. But it may be none can be bought. Then the rule is inapplicable. Some other method by which his loss may be fixed must be used. *Saxe v. Penokee Lumber Co.,* 159 N. Y. 371, 54 N. E. 14.

Such is the case before us. The plaintiff could not purchase the tires from others in Syracuse. He himself was the sole source of supply. Under the circumstances the charge of the trial court was erroneous.

Nor is the error cured by the submission to the jury of other evidence than that of the plaintiff's sales as bearing upon the market price of Dayton tires. There was before it the list price issued by the defendant. This the plaintiff claimed "was the only evidence of market price, aside from the price at which the plaintiff sold." But, as the court said, it did not appear that anything was sold at the list price, nor had it any tendency to show a market in Syracuse at which such tires might be purchased.

As there must be a new trial, we should determine the proper rule of damages. If there was a market elsewhere at which tires in the quantity desired by the plaintiff could be freely purchased the damages would be the difference between the contract price and the price at that market plus the transportation charges to Syracuse. *Cahen v. Platt,* 69 N. Y. 348, 25 Am. Rep. 203; *Wemple v. Stewart,* 22 Barb. 154; *Berry v. Dwinel,* 44 Me. 255. Possibly there was such a market, although, if other buyers from the defendant were limited as was he to sales in specified localities, this may be doubtful. In the absence of such a foreign market, if the plaintiff might purchase a substitute tire, equally available for his reasonable purposes, then his damages would be the difference between the market price of such a substitute and the contract price. *Saxe v. Penokee Lumber Co.,* 159 N. Y. 371, 54 N. E. 14. It should be remarked, however, that this contract contemplated building up a business for the sale of the "Dayton pneumatic tire" and creating a demand for that particular tire. Whether another tire, even equally as good, but sold under another trade-name, would be a satisfactory substitute to a dealer in Dayton tires, may be at least doubtful. It is, however, a question of fact.

Finally, if none of these tests are practicable, another must be adopted. We are not dealing here with circumstances known to both parties at the time the contract was executed, which made it of peculiar value to the plaintiff. We are not concerned

with collateral engagements or consequential damages. We seek some formula under which the jury may determine the natural, the usual, value of such a contract to any one, under ordinary conditions. *Baldwin v. U. S. Tel. Co.,* 45 N. Y. 744, 6 Am. Rep. 165. No one rule can be adapted to fit every case. As the circumstances vary so must the rule. *Gallagher v. Baird,* 54 App. Div. 398, 66 N. Y. Supp. 759; *Masterton v. Mayor, etc., of Brooklyn,* 7 Hill, 61, 42 Am. Dec. 38; *Den Bleyker v. Gaston,* 97 Mich. 354, 56 N. W. 763. Here the tires were purchased to be resold at a profit. This profit, if reasonably certain, may be said to measure the value of the contract to the plaintiff. It was this that he lost by the default of the defendant. Not the gross profit, however, which is what the jury was permitted to allow. What the plaintiff might have made had the contract been carried out was this gross profit less the expense of the business properly chargeable to the sale of the Dayton tire. What this would have been it is for him to show by such evidence as would afford a fair basis for the finding of a jury. A party injured by a broken contract must prove the damages he receives as well as the other elements necessary to permit a recovery.

We decide nothing as to special damages which must be alleged in the complaint. That question is not now before us. We hold only that upon the facts presented, in determining the natural and proximate damages suffered by the plaintiff for the breach of this contract, if the other tests fail, he may prove the ordinary and usual net profits resulting from business conducted in the ordinary and usual way, which he has lost by reason of such breach. *Talcott v. Freedman,* 149 Mich. 577, 113 N. W. 13; *Todd v. Gamble,* 148 N. Y. 382, 42 N. E. 982, 52 L. R. A. 225.

The judgments of the Appellate Division and the trial court should be reversed, and a new trial granted, with costs to abide the event.

HISCOCK, C. J., and CHASE, COLLIN, CARDOZO, POUND, and CRANE, JJ., concur.

Judgments reversed, etc.

§252 *SHERROD v. LANGDON.*

Supreme Court of Iowa, 1866. [21 *Iowa* 518.]

Plaintiffs seek to recover damages resulting, as they allege, from the purchase by them of the defendants of a certain lot of sheep. In one count it is alleged that the sheep were warranted sound, in the other that they were represented to be free from

any disease, and especially such as "foot-rot" and "scab," and that this was false, etc. Upon issue joined, there was a trial. Verdict for plaintiff, judgment thereon, and defendant appeals.

WRIGHT, J.: . . . Plaintiffs had, at the time of purchasing these sheep, other sheep, and these as they claim, became diseased and died because of the "foot-rot" and "scab" imparted to them by the unsound sheep so sold to them by defendants, without fault, etc. The injury to these sheep so owned prior to this purchase, under the instructions, entered as an element in the damage recovered by plaintiffs.

And now the point made is, that this was improper unless defendants knew at the time of such sale that plaintiffs had other sheep. It is not claimed that such damages would not be the natural consequences of defendants' (fraudulent) act, and as such properly recoverable in this action; but the claim is, that this could only be so upon the theory that defendants knew that plaintiffs had other sheep to be infected by the diseases named.

Upon principle this position is not sustainable. Plaintiffs were entitled to recover all the damages of which the act complained of was the efficient cause. The loss of the sheep sold in consequence of their unsound condition was the natural and usual consequence of the act. The other damages were special and peculiar, and they were set forth specifically by the pleader. And upon the assumption that plaintiffs used the care and diligence required at their hands, what matters it whether defendants knew that they had other sheep or not? Or what difference would it make if plaintiff, in ignorance of the unsound condition of these sheep, had afterward bought other sheep, which they lost by reason of the disease communicated to them by those bought of defendants? Defendants sold the sheep with the knowledge that plaintiffs had a right to and probably would place them upon their farm; and, if guilty as charged, they would be held liable for the damages naturally and reasonably resulting from such act. It is known as a matter of fact, that most farmers in this state do keep sheep, and nothing is more important to their success than to secure good, sound flocks. If one lot is procured, there is no duty to refrain from purchasing others, lest those purchased may be unsound, and thus all be lost. But the guarantor, or party making the false representations, sells with a knowledge that his purchaser may have or may purchase other sheep, and cannot screen himself from the consequences of his act upon the ground of ignorance. As well might he sell a weapon dangerous and "infernal" in its structure, representing it to be harmless, and nothing more than a

desirable improvement in firearms, and then escape liability for injury to the purchaser's home or family on the ground that he did not know that he had either. The ground of the recovery is, that the loss actually happened while defendant's wrongful act was in operation—a loss attributable to their wrongful or fraudulent act, and it is not for them to say, we did not know plaintiffs had other sheep, and hence did not contemplate or undertake to be liable for so great a loss. . . .

§253 *HADLEY et al. v. BAXENDALE et al.*

Court of Exchequer, 1854. [9 *Exch.* 341.]

The plaintiffs carried on an extensive business as millers at Gloucester; and on the 11th of May their mill was stopped by a breakage of the crank shaft, by which the mill was worked. The steam engine was manufactured by Messrs. Joyce & Co., the engineers, at Greenwich, and it became necessary to send the shaft as a pattern for a new one to Greenwich. The fracture was discovered on the 12th, and on the 13th plaintiffs sent one of their servants to the office of the defendants, who are the well-known carriers trading under the name of Pickford & Co., for the purpose of having the shaft carried to Greenwich. The plaintiffs' servant told the clerk that the mill was stopped, and that the shaft must be sent immediately and in answer to the inquiry when the shaft would be taken the answer was that if it was sent up by twelve o'clock any day it would be delivered at Greenwich on the following day. On the following day the shaft was taken by the defendants, before noon, for the purpose of being conveyed to Greenwich, and the sum of £2 4*s* was paid for its carriage for the whole distance. At the same time the defendant's clerk was told that a special entry, if required, should be made, to hasten its delivery. The delivery of the shaft at Greenwich was delayed by some neglect, and the consequence was that the plaintiffs did not receive the new shaft for several days after they would otherwise have done, and the working of their mill was thereby delayed, and they thereby lost the profits they would otherwise have received.

On the part of the defendants it was objected that these damages were too remote, and that the defendants were not liable with respect to them. The learned judge left the case generally to the jury, who found a verdict with £25 damages beyond the amount paid into the court [by defendant, which was £25].

ALDERSON, B.: We think that there ought to be a new trial in this case; but in so doing we deem it to be expedient and necessary to state explicitly the rule which the judge, at the next

trial, ought in our opinion, to direct the jury to be governed by when they estimate the damages.

It is, indeed, of the last importance that we should do this; for, if the jury are left without any definite rule to guide them, it will, in such cases as these, manifestly lead to the greatest injustice. The courts have done this on several occasions; and in *Blake v. Railway Co.*, 21 L. J. Q. B. 237, the court granted a new trial on this very ground, that the rule had not been definitely laid down to the jury by the learned judge at *nisi prius.* "There are certain established rules," this court says, in *Alder v. Keighley*, 15 Mees. & W. 117, "according to which the jury ought to find." And the court in that case adds: "And here there is a clear rule that the amount which would have been received if the contract had been kept is the measure of damages if the contract is broken." Now, we think the proper rule in such a case as the present is this: Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally—*i.e.*, according to the usual course of things, from such breach of contract itself—or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them. Now, the above principles are those by which we think the jury ought to be guided in estimating the damages arising out of any breach of contract. It is said that other cases, such as breaches of contract in the non-payment of money, or in the not making a good title to land, are to be treated as exceptions from this, and as governed by a

conventional rule. But as, in such cases, both parties must be supposed to be cognizant of that well-known rule, these cases may, we think, be more properly classed under the rule above enunciated as to cases under known special circumstances, because there both parties may reasonably be presumed to contemplate the estimation of the amount of damages according to the conventional rule. Now in the present case, if we are to apply the principles above laid down, we find that the only circumstances here communicated by the plaintiffs to the defendants at the time the contract was made were that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of that mill. But how do these circumstances show reasonably that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carrier to the third person? Suppose the plaintiffs had another shaft in their possession, put up or putting up at the time, and that they only wished to send back the broken shaft to the engineer who made it, it is clear that this would be quite consistent with the above circumstances, and yet the unreasonable delay in the delivery would have no effect upon the intermediate profits of the mill. Or, again, suppose that, at the time of the delivery to the carrier, the machinery of the mill had been in other respects defective, then also the same results would follow. Here it is true that the shaft was actually sent back to serve as a model for a new one, and that the want of a new one was the only cause of the stoppage of the mill, and that the loss of profits really arose from not sending down the new shaft in proper time, and that this arose from the delay in delivering the broken one to serve as a model. But it is obvious that in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences would not, in all probability, have occurred; and these special circumstances were here never communicated by the plaintiffs to the defendants. It follows, therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract. For such loss would neither have flowed naturally from the breach of this contract in the great multitude of such cases occurring under ordinary circumstances, nor were the special circumstances, which, perhaps, would have made it a reasonable and natural consequence of such breach of contract, communicated to or known by the defendants. The judge ought, therefore, to have told the jury that upon the facts then before them they ought not to take the loss of profits into consideration

at all in estimating the damages. There must therefore be a new trial in this case.

§254 *CORY v. THAMES IRONWORKS & SHIP-BUILDING CO.*

Court of Queen's Bench, 1868. [*L. R.* 3 *Q. B.* 181.]

The plaintiffs are coal merchants and ship owners, having a very large import trade in coal from Newcastle and other places into the port of London. The defendants are iron manufacturers and ship builders in London. The plaintiffs had introduced, at the docks where they discharged the cargoes of coal from their ships, a new and expeditious mode of unloading the coals by means of iron buckets, which were worked by hydraulic pressure over powerful cranes, and the plaintiffs' trade having considerably increased they were desirous of improving the accommodation offered in the discharge of their vessels by the above mode; this the defendants were not aware of. The plaintiffs purchased the derrick for the purposes of their business in order to erect and place in it, as they in fact did, large hydraulic cranes and machinery, such as they had previously used at the docks, and by means of these cranes to tranship their coals from colliers into barges without the necessity for any intermediate landing, the derrick, for this purpose, being moored in the river Thames, and the plaintiffs paying the conservators of the river a large rent for allowing it to remain there. The derrick was the first vessel of the kind that had ever been built in this country, and the purpose to which the plaintiffs sought to apply it was entirely novel and exceptional. No hull or other vessel had ever been fitted either by coal merchants or others in a similar way or for a similar purpose; and the defendants at the date of the agreement had notice that the plaintiffs purchased the derrick for the purpose of their business, considering that it was intended to be used as a coal store; but they had no notice or knowledge of the special object for which it was purchased and to which it was actually applied. At the date of the agreement the defendants believed that the plaintiffs were purchasing the derrick for the purpose of using her in the way of their business as a coal store; but the plaintiffs had not at that time any intention of applying the derrick to any other purpose than the special purpose to which she was in fact afterwards applied. The plaintiffs in anticipation of the delivery of the hull in January, 1862, entered into a contract with Sir William Armstrong for the construction and delivery to them at a very heavy outlay of the necessary ma-

chinery for the purpose for which they purchased the hull, and in consequence of the delay in the delivery of the hull by the defendants the plaintiffs were prevented from taking delivery of the machinery from Sir William Armstrong, and the plaintiffs, on the 25th of July, 1862, paid Sir William Armstrong £3,000, the interest of which was lost to them. The plaintiffs also purchased, at a large cost, two steam tugs to be used, in conjunction with the hull, in towing the coal barges to and from the same, and which steam tugs were comparatively useless to the plaintiffs during the time in which the hull was undelivered, and the interest of the money expended on the same was lost in the plaintiffs; but none of the circumstances were known to the defendants.

If the defendants had delivered the hull to the plaintiffs in proper time the plaintiffs would have realized large profits by the use of it in the aforesaid manner, and they were put to great inconvenience and sustained great loss owing to their not having possession of the hull to meet the great increase in their trade. The plaintiffs also lost £8, 15*s* for interest upon the portion of the purchase-money of the hull paid by them to the defendants before delivery.

The question for the opinion of the court was, whether the plaintiffs were entitled to recover against the defendants the whole or any, and which of the above heads of damage?

J. Brown, Q. C., for the plaintiffs. J. D. Coleridge, Q. C., for the defendants.

COCKBURN, C. J.: I think the construction which Mr. Coleridge seeks to put upon the case of *Hadley v. Baxendale,* 9 Exch. 341, 23 Law J. Exch. 179, is not the correct construction as applicable to such a case as this. If that were the correct construction, it would be attended with the most mischievous consequences, because this would follow, that whenever the seller was not made aware of the particular and special purpose to which the buyer intended to apply the thing bought, but thought it was for some other purpose, he would be relieved entirely from making any compensation to the buyer, in case the thing was not delivered in time, and so loss sustained by the buyer; and it would be entirely in the power of the seller to break his contract with impunity. That would necessarily follow, if Mr. Coleridge's interpretation of *Hadley v. Baxendale,* 9 Exch. 341, 23 Law J. Exch. 179, was the true interpretation. My Brother BLACKBURN has pointed out that that is not the true construction of the language which the court used in delivering judgment in that case. As I said in the course of the argument, the true principle is this, that although the buyer may have sustained

a loss from the non-delivery of an article which he intended to apply to a special purpose, and which, if applied to that special purpose, would have been productive of a larger amount of profit, the seller cannot be called upon to make good that loss if it was not within the scope of his contemplation that the thing would be applied to the purpose from which such larger profit might result; and although, in point of fact, the buyer does sustain damage to that extent, it would not be reasonable or just that the seller should be called upon to pay it to that extent; but to the extent to which the seller contemplated that, in the event of his not fulfilling his contract by the delivery of the article, the profit which would be realized if the article had been delivered would be lost to the other party, to that extent he ought to pay. The buyer has lost the larger amount, and there can be no hardship or injustice in making the seller liable to compensate him in damages so far as the seller understood and believed that the article would be applied to the ordinary purposes to which it was capable of being applied. I think, therefore, that ought to be the measure of damages, and I do not see that there is anything in *Hadley v. Baxendale*, 9 Exch., 341, 23 Law J. Exch. 179, which at all conflicts with this.

Judgment for the plaintiffs accordingly.

§255 *LEONARD v. NEW YORK, A. & B. ELECTRO-MAGNETIC TELEGRAPH CO.*

Court of Appeals of New York, 1870. [41 N. Y. 544.]

[On September 24, 1856, Magill & Pickering, acting for plaintiffs, delivered to the Western Union Company at Chicago, a dispatch to be sent to Oswego, as follows: "D. B. Staats, Oswego: Send 5,000 sacks of salt immediately. Magill & Pickering." The dispatch was sent by the Western Union Company to Buffalo, and there delivered to the agent of the defendants. It was transmitted by the defendants over their line to Syracuse; and in transcribing it at this point for the purpose of delivering to the Oswego line, the agent of defendants negligently wrote the word "casks" in place of "sacks," so that when the message was delivered to the Oswego line, and by that line to Staats, it read as follows: "D. B. Staats, Oswego: Send 5,000 casks of salt immediately. Magill & Pickering."

The term "sacks" in the salt trade designates fine salt in sacks containing fourteen pounds, and the term "casks" designates coarse salt in packages containing not less than three hundred and twenty pounds.

Staats received the telegram on the afternoon of September

24, 1856, and that evening or the next morning, chartered the schooner S. H. Lathrop, to take the salt to Chicago, and shipped by her 2,733 and 200/280 barrels of coarse salt. The cargo of salt arrived at Chicago on October 15. There was no market for it at Chicago, and Magill & Pickering stored it at the expense of the plaintiffs until 1857, when it was sold for less than one dollar per barrel. The salt was worth at the time of its shipment in Oswego, $1.60 per barrel.]

EARL, C. J.: . . . It is also claimed that the referee adopted an erroneous rule of damages, and that the plaintiffs should not in any event have recovered more than they actually disbursed for freight on the salt to Chicago. The measure of damages to be applied to cases as they arise has been a fruitful subject of discussion in the court. The difficulty is not so much in laying down general rules, as in applying them. The cardinal rule undoubtedly is, that the one party shall recover all the damages which has been occasioned by the breach of contract by the other party. But this rule is modified in its application by two others. The damages must flow directly and naturally from the breach of contract, and they must be certain, both in their nature and in respect to the cause from which they proceed. Under this latter rule speculative, contingent and remote damages, which cannot be directly traced to the breach complained of, are excluded. Under the former rule, such damages are only allowed as may fairly be supposed to have entered into the contemplation of the parties when they made the contract, as might naturally be expected to follow its violation. It is not required that the parties must have contemplated the actual damages which are to be allowed. But the damages must be such as the parties may fairly be supposed to have contemplated when they made the contract. Parties entering into contracts usually contemplate that they will be performed, and not that they will be violated. They very rarely actually contemplate any damages which would flow from any breach, and very frequently have not sufficient information to know what such damages would be. As both parties are usually equally bound to know and be informed of the facts pertaining to the execution or breach of a contract which they have entered into, I think a more precise statement of this rule is, that a party is liable for all the direct damages which both parties to the contract would have contemplated as flowing from its breach, if at the time they entered into it they had bestowed proper attention upon the subject, and had been fully informed of the facts. In this case then, in what may properly be called the fiction of law, the defendant must be presumed to have known that this

dispatch was an order for salt, as an article of merchandise, and that the plaintiff would fill the order as delivered; and that if the salt was shipped to Chicago, it would be shipped there as an article of merchandise, to be sold in the open market. And the market price in Chicago being less than the market price in Oswego, that they would lose the cost of transportation, and the difference between the market price at Chicago and the market price at Oswego. I think, therefore, that the rule of damages adopted by the referee was sufficiently favorable to the defendant. The damages allowed were certain, and they were the proximate, direct result of the breach.

I do not think, under the facts of this case, that the plaintiffs, when they found the state of the Chicago market, were bound to re-ship this salt to Oswego. For anything that appears in this case, the cost of transportation to Oswego would have been equal to the difference in the market price between the two places. Then there was the risk of the lake transportation at that season of the year, and the uncertainty in the Oswego market when the salt should again be landed there. If the plaintiff had shipped it, and it had been lost upon the lake, the total loss would not have been chargeable to the defendant. By the wrongful act of the defendant, the salt had been placed in Chicago, one of the largest commercial centers in the country, and the plaintiffs had the right to sell it there in good faith, and hold the defendant liable for the loss. . . .

§256 *PRIMROSE v. WESTERN UNION TELEGRAPH COMPANY.*

Supreme Court of United States, 1894. [154 U. S. 1.]

On June 16, 1887, the plaintiff wrote and delivered to the defendant at Philadelphia, for transmission to his agent, William B. Toland, at Ellis, in the state of Kansas, a message:

"To Wm. B. Toland, Ellis, Kansas:

"Despot am exceedingly busy bay all kinds quo perhaps bracken half of it mince moment promptly of purchases.

"Frank J. Primrose."

On the evening of the same day, an agent of the defendant delivered to Toland, at Waukeney, upon a blank of the defendant company, the message in this form:

"To W. B. Toland, Waukeney, Kansas:

"Destroy am exceedingly busy buy all kinds quo perhaps bracken half of it mince moment promptly of purchase.

"Frank J. Primrose."

The difference between the message as sent and as delivered is shown below, where so much of the message sent as was omitted in that delivered is in brackets, and the words substituted in the message delivered are in italics.

"[Despot] *Destroy* am exceedingly busy [bay] *buy* all kinds quo perhaps bracken half of it mince moment promptly of purchase [s]."

By the private cipher code made and used by the plaintiff and Toland, the meaning of these words was as follows:

"Yours of the [fifteenth] *seventeenth* received; am exceedingly busy; [I have bought] *buy* all kinds, five hundred thousand pounds; perhaps we have sold half of it; wire when you do anything; send samples immediately, promptly of [purchases] *purchase*."

The plaintiff testified that he then was, and for many years had been engaged in the business of buying and selling wool all over the country, and had employed Toland as his agent in that business, and early in June, 1887, sent him out to Kansas and Colorado, with instructions to buy 50,000 pounds, and then to await orders from him before buying more; that, before June 12th, Toland bought 50,000 pounds, and then stopped buying; and that he had sent many telegraphic messages to Toland during that month and previously, using the same code.

The defendant's agent at Philadelphia, called as a witness for the plaintiff, testified that he sent this message for the plaintiff, and knew that he was a dealer in wool, and that Toland was with him, but in what capacity he did not know; that he had frequently sent messages for him, and considered him one of his best customers during the wool season. The plaintiff also introduced evidence tending to show that June 16, 1887, was a bright and beautiful day at Ellis and Waukeney; that Toland, upon receiving the message at Waukeney, made purchases of about 300,000 pounds of wool; and that the plaintiff, in settling with the sellers thereof, suffered a loss of upwards of $20,000.

GRAY, J.: . . . Under any contract to transmit a message by teleghaph, as under any other contract, the damages for a breach must be limited to those which may be fairly considered as arising according to the usual course of things from the breach of the very contract in question, or which both parties must reasonably have understood and contemplated, when making the contract, as likely to result from its breach. This was directly adjudged in *Telegraph Co. v. Hall,* 124 U. S. 444, 8 Sup. Ct. 577, 31 L. Ed. 479. . . .

In *Telegraph Co. v. Gildersleeve,* 29 Md. 232, which was an action by the sender against a telegraph company for not delivering this message received by it in Baltimore, addressed to brokers in New York, "Sell fifty (50) gold," Mr. Justice Alvey, speaking for the Court of Appeals of Maryland, and applying the rule of *Hadley v. Baxendale,* above cited, said: "While it was proved that the dispatch in question would be understood among brokers to mean fifty thousand dollars of gold, it was not shown, nor was it put to the jury to find, that the appellant's agents so understood it, or whether they understood it at all. 'Sell fifty gold' may have been understood in its literal import, if it can be properly said to have any, or was as likely to be taken to mean fifty dollars as fifty thousand dollars by those not initiated; and, if the measure of responsibility at all depends upon a knowledge of the special circumstances of the case, it would certainly follow that the nature of this dispatch should have been communicated to the agent at the time it was offered to be sent, in order that the appellant might have observed the precautions necessary to guard itself against the risk. But without reference to the fact as to whether the appellant had knowledge of the true meaning and character of the dispatch, and was thus enabled to contemplate the consequences of a breach of the contract, the jury were instructed that the appellee was entitled to recover to the full extent of his loss by the decline in gold. In thus instructing the jury, we think the court committed error, and that its ruling should be reversed." 29 Md. 232, 251, 96 Am. Dec. 519.

In *Baldwin v. Telegraph Co.,* which was an action by the senders against the telegraph company for not delivering this message: "Telegraph me at Rochester what that well is doing," Mr. Justice Allen, speaking for the Court of Appeals of New York, said: "The message did not import that a sale of any property or any business transaction hinged upon the prompt delivery of it, or upon any answer that might be received. For all the purposes for which the plaintiffs desired the information, the message might as well have been in a cipher or in an unknown tongue. It indicated nothing to put the defendant upon the alert, or from which it could be inferred that any special or peculiar loss would ensue from a non-delivery of it. Whenever special or extraordinary damages, such as would not naturally or ordinarily follow a breach, have been awarded for the non-performance of contracts, whether for the sale or carriage of goods or for the delivery of messages by telegraph, it has been for the reason that the contracts have been made with reference to peculiar circumstances known to both, and the particular

loss has been in the contemplation of both, at the time of making the contract, as a contingency that might follow the non-performance." "The dispatch not indicating any purpose other than that of obtaining such information as the owner of property might desire to have at all times, and without reference to a sale, or even a stranger might ask for purposes entirely foreign to the property itself, it is very evident that whatever may have been the special purpose of the plaintiffs, the defendant had no knowledge or means of knowledge of it, and could not have contemplated either a loss of a sale, or a sale at an undervalue, or any other disposition of or dealing with the well or any other property, as the probable or possible result of a breach of its contract. The loss which would naturally and necessarily result from the failure to deliver the message would be the money paid for its transmission, and no other damages can be claimed upon the evidence as resulting from the alleged breach of duty by the defendant." 45 N. Y. 744, 749, 750, 752, 6 Am. Rep. 165. See, also, *Hart v. Cable Co.*, 86 N. Y. 633.

The Supreme Court of Illinois, in *Tyler v. Telegraph Co.*, 60 Ill. 421, took notice of the fact that in that case "the dispatch disclosed the nature of the business as fully as the case demanded." 60 Ill. 434, 14 Am. Rep. 38. And in the recent case of *Cable Co. v. Lathrop*, the same court said: "It is clear enough that, applying the rule in *Hadley v. Baxendale, supra*, a recovery cannot be had for a failure to correctly transmit a mere cipher dispatch, unexplained, for the reason that to one unacquainted with the meaning of the ciphers it is wholly unintelligible and nonsensical. An operator would, therefore, be justifiable in saying that it can contain no information of value as pertaining to a business transaction, and a failure to send it or a mistake in its transmission can reasonably result in no pecuniary loss." 131 Ill. 575, 585, 23 N. E. 583, 7 L. R. A. 474, 19 Am. St. Rep. 55. . . .

In the present case the message was, and was evidently intended to be, wholly unintelligible to the telegraph company or its agents. They were not informed, by the message or otherwise, of the nature, importance, or extent of the transaction to which it related, or of the position which the plaintiff would probably occupy if the message were correctly transmitted. Mere knowledge that the plaintiff was a wool merchant, and that Toland was in his employ, had no tendency to show what the message was about. According to any understanding which the telegraph company and its agents had, or which the plaintiff could possibly have supposed that they had, of the contract between these parties, the damages which the plaintiff seeks

to recover in this action, for losses upon wool purchased by Toland, were not such as could reasonably be considered, either as arising, according to the usual course of things, from the supposed breach of the contract itself, or as having been in the contemplation of both parties, when they made the contract, as a probable result of a breach of it.

In any view of the case, therefore, it was rightly ruled by the Circuit Court that the plaintiff could recover in this action no more than the sum which he had paid for sending the message.

Judgment affirmed.

FULLER, C. J. and HARLAN, J., dissented.

§257. *The Nature of a Telegraph Company's Liability.*—The weight of authority is in accord with the Primrose case on the question of the measure of damages. For a summary of cases on a Telegraph Company's duty with respect to cipher and unintelligible telegrams, see the note in 43 L. R. A. (N. S.) 502. *Cf.* also *Postal Telegraph Cable Co. v. Warren-Godwin Lumber Co.* (1919), 251 U. S. 27.

The case of *Primrose v. Western Union Telegraph Co.* is also interesting because it raises the problem of how far the law will enforce certain stipulations limiting the liability of such companies which are now commonly contained in the printed blanks on which the sender writes his message.

1. May a telegraph company by contract exempt itself from liability caused by negligence? The decided weight of authority answers in the negative. It may, however, by special contract with the sender limit its liability to defaults occurring on its own line, and protect itself against liability arising from negligence of a connecting company.

2. May it enforce a stipulation to the effect that it will not be liable for errors, delays or non-delivery of messages for more than the amount received for sending, unless the message is ordered to be repeated? The authorities are about evenly divided but perhaps the weight of authority on the point is opposed to the Primrose case. Most of the state courts hold that this stipulation also is against public policy and therefore unenforceable. There are also some state statutes to that effect.

But in the case of interstate messages the Act of Congress of July 18, 1910 (4 Fed. St. Ann. 2d ed. 337) is interpreted as permitting this limitation of liability.

3. May it enforce a stipulation providing that all claims for damages against the company must be presented in writing within a certain time after the message is filed for transmission? Again the authorities are in conflict, but the decided weight of authority holds that the stipulation is not unreasonable and therefore is enforceable, if the time fixed be not unreasonably short.

4. May it enforce a stipulation exempting itself from liability for the loss resulting from errors made in the transmission of cipher or obscure messages? The weight of authority follows the Primrose case in upholding the validity of such a stipulation.

§258 *LAWRENCE et al. v. PORTER et al.*

Circuit Court of Appeals of United States, 1894.
[11 C. C. A. 27.]

Before TAFT and LURTON, JJ.

LURTON, J.: . . . This is an action for breach of a contract of sale brought by the buyers against the sellers for failure to deliver a large quantity of lumber according to the terms of the agreement. The lumber was to be delivered by the defendants at their mill, on vessels to be furnished by the plaintiffs, during the shipping season of 1890. As each cargo was received, the buyer was to give acceptances, payable in ninety days. After the delivery of one cargo, the defendants refused, for no sufficient reason, to deliver the remainder upon the terms of the bargain, but offered to supply the lumber needed to complete the bill at a reduction of 50 cents on each 1,000 feet, for cash on delivery over the rail of plaintiffs' vessels and at the time when delivery was required by the broken agreement. The buyers stood upon their contract and demanded delivery upon the credit therein stipulated and refused to take the lumber offered by the delinquent sellers on any other terms than those contained in the agreement. There was evidence tending to show that the quantity and quality of lumber contracted for, and of the dimensions designated, could not be procured at the place of delivery from others than the defendants, or at any

other available market in time for shipment according to the terms of the contract; that the lumber was intended for resale at Tonawanda, N. Y.; that defendants were so informed; and that the market value of such lumber at Tonawanda, after deducting freight and hauling, was considerably above the contract price. . . .

The ground upon which the defendants refused to carry out the sale was ostensibly their unwillingness to extend to the plaintiffs the credit of ninety days provided for in the agreement of sale. They have not endeavored to show that there were any circumstances which justified this breach of the agreement. Credit is often a material element in a contract of sale, whereby the buyer is enabled to operate upon the capital of the seller. Credit extended without interest, is, in effect, a sale at the stipulated price less the interest for the period of credit. The damage for a breach of contract to pay money at a particular date is the lawful rate of interest for the period of default, unless some other penalty is imposed by the agreement. So it would seem that if the buyer, in order to supply himself with the articles which the seller was obligated to sell, is compelled to buy from another, and to pay cash, one element of recovery for the breach would be interest upon his purchase for the period of credit. It is the well-settled duty of the buyer, when the seller refuses to deliver the goods contracted for, to do nothing to aggravate his injury. Indeed, he must do all that he reasonably can mitigate the loss. If the buyer could have supplied himself with goods of like kind, at the place of delivery or other available market, at the time the contract was broken, and neglected to do so, whereby he suffered special damages by reason of the breach, he will not be suffered to recompense himself for such special damage, for the reason that to that extent he has needlessly aggravated the loss. The contention of the plaintiffs is that they could not supply themselves at the time the contract was broken with lumber of the qualities and sizes mentioned in their contract either at the place of delivery or at any other available market; that they were not required to buy from the defendants, who were already in default; that to have bought from them would operate both to encourage breaches of contracts, and would have been a waiver of all other right of recovery for the breach of their agreement; that to have accepted the proposal of the defendants to supply them for cash at the reduced price would simply have been to substitute one contract for another, thereby enabling defendants to escape all liability for a deliberate and indefensible violation of the bargain. They, therefore, insist that the measure of dam-

age was the difference between the contract price and the market value at Tonawanda, N. Y., less freights to that point; the evidence showing that the lumber was bought for resale at Tonawanda, and that defendants were informed of that purpose.

For a breach of contract of sale, the law imposes no damages by way of punishment. The innocent party is simply entitled to recover his real loss. If the market value is less than the contract price, the buyer has sustained no loss. This is axiomatic, and needs no citation of authority. If the plaintiffs could have bought at East Jordan, or at any other convenient and available market, at the time of the breach, lumber of like kinds, at the same price or a less price, it would be clear that they would have sustained no general damages. If they refused to avail themselves of such opportunity, and thereby sustained special and unusual loss, by reason of not having lumber of the kinds called for by the contract, or by being deprived of a profit resulting from a resale at Tonawanda, they could not recover such special damage, for such damage might have been avoided by replacing the undelivered lumber by other of like kinds. The fact that they could only buy from the defendants does not affect the duty of plaintiffs to minimize their loss as far as they reasonably could. The offer to sell for cash at a reduced price more than equalized the interest for ninety days, which was the value of credit. There seems to be no insurmountable objection in thus permitting a delinquent contractor to minimize his loss. The obligation on the buyer to mitigate his loss, by reason of the seller's refusal to carry out such a sale, is not relaxed because the delinquent seller affords the only opportunity for such reduction of the buyer's damage. *Warren v. Stoddart,* 105 U. S. 224, 26 L. Ed. 1117; *Deere v. Lewis,* 51 Ill. 254. . . .

The opinion in *Warren v. Stoddart* rests upon the theory that the buyer does not surrender or yield any right of action he may have for the breach of contract. It rests wholly upon the duty of mitigating the loss by replacing the goods by others, if they are obtainable by reasonable exertion. If this duty be such as to require him to buy from the delinquent seller; if the article can be obtained only from him, or because he offers it cheaper than it can be obtained from others, such a purchase from the seller is not the abandonment of the original contract by the substitution of another, nor would the purchase operate to the seller's advantage, save in so far as the damage resulting from his bad faith was thereby reduced. If the seller offers

to sell for cash at a reduced price, or to sell for a less price than the market price, though in excess of the contract price, with the condition that it should operate as a waiver of the original contract, or of any right of action for its breach, then the buyer would not be obligated to treat with the seller, nor would the seller's offer, if rejected, operate as a reduction of damages.

The case of *Deere v. Lewis,* cited above, was a case much like the one under consideration. The goods could be procured only from the defendant, who offered the goods for cash at 5 per cent. less than the contract price. It was held that the plaintiff could recover only nominal damages, inasmuch as he could have bought the goods for less than the contract price from the delinquent seller.

The case of *Havemeyer v. Cunningham,* 35 Barb. (N. Y.) 515, and *Manufacturing Co. v. Randall,* 62 Iowa, 244, 17 N. W. 507, have been cited as sustaining a different result. The first case rested upon a state of facts very unlike those here involved. The other seems to have gone off upon the apprehension that, if the buyer supplied himself by a purchase from the delinquent seller, he thereby abandoned his contract, and substituted a new agreement in place of the broken bargain. That apprehension seems unjustified. But, however that may be, the case of *Warren v. Stoddart* is controlling. The offer after the breach by the defendants to sell the lumber necessary to complete the contract was not coupled with any condition operating as an abandonment of the contract, nor as a waiver of any right of action for damages for the breach. . . .

§259. *Penalty Distinguished From Damages for Breach.*—In considering the rule requiring the mitigation of damages by the injured party, regardless of the wrong done by the party violating the agreement, it must be remembered that punishment is no part of the purpose of assessing damages in contract cases. It has even been said epigramatically, that a contract is made to be broken; that is to say, when a contract is made, among its implied terms are provisions for the contingency of breach. The statement must not be taken too literally, however, for, as we have seen, there are many contracts for the breach of which damages are not considered adequate remedies, and in which specific performance will accordingly be decreed. Compare the following cases:

C. Specific Performance

§260 *JONES v. PARKER.*

Supreme Judicial Court of Massachusetts, 1895. [163 Mass. 564.]

HOLMES, J.: The case of *Jones v. Parker* is a bill in equity brought by a lessee upon a lease purporting to begin on September 1, 1893, and to demise part of a basement in a building not yet erected. The lessor "covenants to deliver possession of the same to the lessee upon completion of said building, and thereafter, during the term of this lease, reasonably to heat and light the demised premises." It is alleged that the building has been completed, but that the defendants refuse to complete the premises with apparatus sufficient to heat and light the same, and to deliver the same to the plaintiff. It also is alleged that occupancy of the premises for the purpose contemplated in the lease was impossible without the construction in the premises of proper apparatus for heating and lighting them before delivery to the plaintiff. The prayer is for specific performance of the covenant quoted, and for damages. The defendant demurs.

It does not need argument to show that the covenant is valid. Whether it should be enforced specifically admits of more doubt, the questions being whether it is certain enough for that purpose, and whether a decree for specific performance would not call on the court to do more than it is in the habit of undertaking. We are of opinion that specific performance should be decreed. With regard to the want of certainty of the covenant, if the plaintiff were left to an action at law, a jury would have to determine whether what was done amounted to a reasonable heating and lighting. A judge sitting without a jury would find no difficulty in deciding the same question. We do not doubt that an expert would find it as easy to frame a scheme for doing the work. The other question is practical rather than a matter of precedent. It fairly is to be supposed, in the present case, that the difference between the plaintiff and the defendants is only with regard to the necessity of some more or less elaborate apparatus for light and heat, a difference which lies within a narrow compass and which can be adjusted by the court. There is no universal rule that courts of equity never will enforce a contract which requires some building to be done. They have enforced such contracts from the earliest days to the present time.

A further objection is taken, that the instrument is a lease and therefore there is a remedy for possession of the premises

at law, and that the covenant to heat and light is not to be performed until after possession is taken. It would be a sufficient answer that performance of the covenant to heat and light was to begin at the moment of performance of the covenant to deliver possession, and that the defendant is alleged to have repudiated both of these obligations. But we may go further. According to the allegations of the bill, occupation of the premises for the contemplated purposes is impossible without the completion of them by the construction therein of proper apparatus for heating and lighting. The covenant itself affords an argument that artificial light and heat were necessary constituents of the premises, as natural light was in the case of *Brande v. Grace*,[1] or a cistern in *Cleves v. Willoughby*.[2] It is "so interwoven with the original contract as to become an essential part of it." If so, the plaintiff would not be bound to accept possession if offered without artificial light and heat, *Cleves v. Willoughby, ubi supra*, and although it has been said with truth, in a different class of cases, that the mode in which one party to a bargain shall enable himself to do what he has agreed to do is no part of the contract, *Pratt v. American Bell Telephone Co.*,[3] the present covenant fairly may be construed to mean that, at the moment when delivery of possession is due there shall be the necessary machinery or apparatus without which it would be impossible thereafter . . . reasonably to heat and light the demised premises. . . ."[4]

§261. *The Scope of Specific Performance.*—It has been stated in the textbooks that specific performance will be decreed for contracts pertaining to interests in land, subject to the exception that building contracts will not be specifically enforced because they would generally require too much supervision by the court. The above case presents a kind of exception to the exception. In addition, it corrects the popular statement of the rules in several particulars. Thus, there is no essential difference between the specific performance of land contracts and contracts pertaining to other interests in which the subject-matter is considered unique. Compare the following case:

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[1] 154 Mass. 210.
[2] 7 Hill (N. Y.) 83, 90, 91.
[3] 141 Mass. 225, 229.
[4] The learned judge's references to Fry on *Specific Performance*, Story on *Equity Jurisprudence*, and to numerous cases have been omitted.

§262 *CORBIN v. TRACY AND ANOTHER.*

Supreme Court of Errors of Connecticut, 1867. [34 *Conn.* 325.]

Bill in equity, brought by the petitioners, a joint stock corporation, to the Superior Court for Hartford County, to compel the specific performance of a contract to assign a patent right. The Superior Court (Loomis, J.) passed a decree in favor of the petitioners, and the respondents filed a motion for a new trial and a motion in error. The case is sufficiently stated in the opinion.

CARPENTER, J.: Under the motion in error, it is objected that the petitioners have not made out a case for the interference of a court of equity; that courts of equity in this state will not interfere to enforce agreements to sell personal property unless the circumstances are such as to make a trust, because there is in such a case a remedy at law by an action for damages.

The objection assumes that there is a distinction in questions of this character between real and personal property. If any such distinction exists it does not go to the extent claimed.

The ground of the jurisdiction of a court of equity in this class of cases is that a court of law is inadequate to decree a specific performance, and can relieve the injured party only by a compensation in damages, which in many cases would fall far short of the redress which his situation might require. Whenever, therefore, the party wants the thing *in specie,* and he cannot otherwise be fully compensated, courts of equity will grant him a specific performance. They will decree the specific performance of a contract for the sale of lands, not because of the peculiar nature of land, but because a party cannot be adequately compensated in damages. So in respect to personal estate; the general rule that courts of equity will not entertain jurisdiction for a specific performance of agreements respecting goods, chattels, stocks, choses in action, and other things of a merely personal nature, is limited to cases where a compensation in damages furnishes a complete and satisfactory remedy.

The jurisdiction, therefore, of a court of equity does not proceed upon any distinction between real estate and personal estate, but upon the ground that damages at law may not in the particular case afford a complete remedy. When the remedy at law is not full and complete, and when the effect of the breach cannot be known with any exactness, either because the effect will show itself only after a long time, or for any other reason, courts of equity will enforce contracts in relation to personality.

An application of these principles to the case before us relieves it of all difficulty. The contract relates to a patent right, the value of which has not yet been tested by actual use. All the data by which its value can be estimated are yet future and contingent. Experience may prove it to be worthless; another and better invention may supersede it; or it may itself be an infringement of some patent already existing. On the other hand, it may be so simple in its principle and construction as to defy all competition, and give its owner a practical monopoly of all branches of business to which it is applicable. In any event its value cannot be known with any degree of exactness until after the lapse of time; and even then it is doubtful whether it can be ascertained with sufficient accuracy to do substantial justice between the parties by a compensation in damages. On the whole we are satisfied that justice can only be done in a case like this by a specific performance of the contract.

There is, therefore, no error in the decree complained of.

In this opinion the other judges concurred.

D. Declaratory Judgments and Judicial Administration of Business.

§263. *Declaratory Judgments.*—The normal case in Anglo-American courts involves, according to the ideal represented in common law pleading, two parties between whom there is a single concrete subject of litigation, the one seeking a remedy through the intervention of the courts, the other resisting. The "declaratory judgment," for example, that is, the adjudication of a genuine dispute between two parties as to their rights before any breach occurs or damage is suffered, has generally been withheld, except when accompanied by the fiction of nominal damages. Recently a strong movement has developed in favor of the declaratory judgment both in England and in America. In commenting on statutes on this subject the Committee on Noteworthy Changes in Statute Laws of the American Bar Association said in 1919 (Report, p. 280):

> Much of our modern legislation represents an effort to make more definite the requirements of the general rules of the common law in their application to constantly changing business, economic and social conditions. Business men, particularly, are not satisfied merely to know

> that they will be able to obtain the protection of the courts to secure relief for wrongs done to them, and to resist claims for wrong alleged to have been done by them. Modern business requires speed and security for the basis of its transactions. Men want to know what they can do and what they cannot do before acting. They want to know that action taken in reliance upon a statute, or upon a contract or other written instrument, may not be set aside by subsequent judicial interpretation.

In 1920 the Committee on Jurisprudence and Law Reform in its annual report to the same body advocated the Declaratory Judgment. (6 Am. Bar Assn. Journ. 494. The best general account of the subject is Professor Edwin M. Borchard's essay, *The Declaratory Judgment—a Needed Procedural Reform,* in 28 Yale, L. J. 105.)[1]

Even where redress rather than a declaration is sought, the simple model of one plaintiff against one defendant is frequently inadequate. Equity has taken care of many of these cases; for example: interpleader, where a stakeholder asks that two claimants be made to interplead for the stake and that he be relieved; bills of peace, in which there are many adverse claims of a single right; riparian cases in which the claims of a great number of persons must be co-ordinated. In addition, there are many instances in which the court's business is really administration, rather than adjudication. This is true in partition proceedings with reference to real estate in the administration of the estates of deceased persons, in the administration of insolvent estates, in bankruptcy and generally in the winding up of the affairs of a business. For the purpose of illustrating the administrative business of courts, we may consider the settlement of claims against insolvents and bankrupts.

§264. *The Administration of Insolvent Estates.*—A debtor

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[1]A Michigan Declaratory Judgment Act (Act No. 150, P. A. 1919) has been held unconstitutional on the ground that it called upon the courts to exercise powers and perform duties not judicial in their nature. *Anway v. Grand Rapids Railway Co.* (1920), 179 N. W. 350. Similar statutes have been enacted in Florida, New Jersey, New York, Kansas and Wisconsin.

is said to be insolvent when he is unable to pay his debts as they accrue in the course of business.[1]

Until comparatively modern times insolvency was assumed to be due to fraud on the part of the debtor. After the eighteenth century, however, the function of capital became such an important part in the economic system that it entirely altered the old conditions under which credit was given, and put the relations between debtors and creditors on an entirely different basis. The early drastic laws against debtors came to be regarded not only as unjust but impolitic. Accordingly during the first half of the last century the old laws permitting the arrest and imprisonment of an honest debtor were done away with practically everywhere, either by legislative enactments or constitutional provisions. When the non-payment of a debt is accompanied with fraud or breach of trust, or the debtor is about to abscond, or it can be shown he can but will not pay, it will be generally agreed that the debtor is deserving of punishment, and the laws of most states expressly permit the arrest of such a debtor.

From the standpoint of business, the important questions as regards insolvency are those which have to do with the distribution of the assets of the insolvent person, and with his discharge from his debts. The discussion in this chapter, therefore, is directed to those doctrines of the law which are applicable to these questions.

The main topics to be considered are as follows:

(1) Composition with Creditors. A composition agreement is an arrangement whereby several or all of the creditors of a failing debtor compromise their claims and accept the payment of a percentage of them in full satisfaction and discharge of the whole.

(2) General Assignment for the Benefit of Creditors. This transaction consists of a voluntary conveyance of property by

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[1]The meaning of the word "insolvency" as used in the federal Bankruptcy Act is different. There it denotes the insufficiency of one's total assets (at a fair valuation) to discharge his total liabilities. The term is understood in this latter sense in *Mueller v. Fire Clay Co.* (1898), 183 Pa. 450, but not generally in the state courts. *Cf.* Uniform Sales Act, Section 76. See §267, *infra*.

the debtor to a trustee for the benefit of any or all of his creditors.

(3) Bankruptcy Proceedings. Proceedings of this kind owe their origin entirely to legislation and are under the immediate direction and full control of a court. The statute now in force in this country is the National Bankruptcy Law of 1898, and amendments of 1903, 1906, 1910, and 1917.

(4) Receiverships of Insolvent Corporations. The appointment of receivers is a form of preventive remedy afforded by equity whenever it is expedient that the court itself should take charge of property involved in a litigation, with a view of preserving it from threatened waste or destruction during the continuance of the litigation. Modern statutes in many states have extended this remedial action to subjects lying outside the original scope of equitable jurisdiction, particularly with respect to insolvent corporations. Apart from such statutes, however, courts of equity, under certain circumstances, undertake a general administration of the property of an insolvent corporation and as an incident to the process of distribution, take over temporarily the care and management of the property of the insolvent corporation. "The management is an interim management; its necessity and its justification spring out of the jurisdiction to liquidate and to sell; the business or undertaking is managed and continued in order that it may be sold as a going concern, and with the sale the management ends."[1] In exercising its jurisdiction to liquidate and distribute the assets in the hands of the receiver, a court of equity usually follows the principle of ratable distribution which is one of the characteristics of modern bankruptcy legislation. Frequently, of course, liquidation and final distribution by a decree in equity is unnecessary; when all parties in interest have assented to a reorganization arrangement the bill for general administration is dismissed and the receivership terminated.

§265. *Composition with Creditors.*—The agreement between a debtor and all, or a number of his creditors whereby each of

[1] *Gardner v. London, etc., Ry.* (1867), L. R. 2 Ch. App. 201, 212. Cairns, L. J.

the latter is to receive part of the debt due him in satisfaction of the whole is known as a composition. Although it is law in most states that an attempt to discharge a debt is ineffective when there is an agreement between a debtor and a single creditor that the debtor shall be discharged from all liability on a liquidated, undisputed claim upon his paying a part of the debt,[1] it is otherwise with a composition.[2] The latter method of discharging the debts of an insolvent person is now not uncommonly subject to regulation by special statutes.

§266. *General Assignment.*—A debtor makes a general assignment for the benefit of creditors when he transfers his property to a trustee, commonly called an assignee, upon an undertaking by the latter to convert the property into cash, and to distribute the proceeds among the creditors of the assignor. Transactions of this kind are simply an application of the common law principles governing conveyances and trusts, and in no respect depend on a statute. They are commonly called voluntary assignments, to distinguish them from such as result from the compulsion of the law. Many states have, however, passed laws giving a statutory effect to a voluntary assignment which complies with certain specific rules. Most statutes of this kind provide that the debtor may be discharged from further liability to creditors who actually proved their claims, but do not allow him a discharge from all provable claims.

Technically, a general assignment is one of the transactions prohibited by the statute of Elizabeth relating to fraudulent conveyances.[1] When made under certain circumstances it is held to be fraudulent as a matter of course. This is true whenever a general assignment is made by a debtor who is solvent and his object is to compel creditors to wait until his assignee can realize upon the property to better advantage than would be possible under a forced sale. A solvent debtor is never entitled to procure a delay by means of a transfer of his property, whether the transfer be by way of a general assignment or in any other

[1]See §114, *supra.*
[2]*Good v. Cheeseman* (1831), 2 B. & Ad. 335.

[1]See §269, *infra.*

way. If, however, a debtor is insolvent and the general assignment prescribes an immediate liquidation and distribution of the assets, the courts uphold the transfer, even though the motive was to defeat a particular creditor who has gained the first step upon the other creditors. In this particular situation courts have preferred to follow their business instincts rather than strict rules of statutory construction. From a business standpoint it is plain enough that a general assignment of the kind described is for the benefit of the creditors as a whole, and not that of the debtor. It "procures an equal distribution amongst all of the fund to which all have an equal right," as Lord Ellenborough once said, and it relieves each creditor from the necessity of competing with other creditors in a race for a prior judgment with its preferred position as regards the seizure and sale of the debtor's property.

In the view of the great majority of American courts a general assignment is a fraudulent conveyance unless at least some of the creditors should assent to it and thereby furnish the consideration which is deemed necessary to give validity to the transaction. This is, however, largely a fictional requirement, inasmuch as most courts hold that with respect to an assignment entitling all creditors to share pro rata "the assent is presumed in the absence of evidence to the contrary."[2]

In approval of a general assignment by an insolvent debtor the transaction has been described as "a discharge of the moral duties attached to his character of debtor to make the fund available for the whole body of creditors."[3] In point of fact however, the common law, which permitted a debtor to pay one or more of his creditors in full before making any provision for the others, interposed no obstacles to his making an assignment with such preferences as he chose. To give a favored creditor the lion's share of the debtor's property is repugnant to one's sense of fairness, and statutes regulating general assignments in

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[2]The usual American doctrine does not prevail in Massachusetts. It is held in that state that an assignment is a fraudulent conveyance and therefore invalid unless it is actually assented to by creditors; if the claims of the assenting creditors fall short of exhausting the assets conveyed to the assignee, the assignment is upheld only to the extent to which the claims of the assenting creditors would cause a depletion of such assets.

[3]Lord Ellenborough *Pickstock v. Lyster* (1815), 3 M. & S. 371, 375.

nearly all of the states, either qualify the right to make a preferential assignment or take it away entirely. Moreover, a debtor who makes an assignment is now always under the shadow of the National Bankruptcy Act. This Act makes an assignment for the benefit of creditors an "act of bankruptcy," that is, a ground for putting the debtor into involuntary bankruptcy. For these reasons, a debtor now-a-days nearly always draws up his assignment in a form which is fair and equitable to all creditors. As a practical matter there is no good reason why a creditor should withhold his assent to an assignment if he is convinced that the debtor is honest and that the agreement is fair to all the creditors. Experience has abundantly proved that settlements made outside of the court by the consent of the parties are generally financially more advantageous to creditors than distributions effected under an insolvency law or a bankruptcy act, the voluntary adjustment being more speedy and less expensive, and in most instances bringing in larger percentages to creditors.

§267. *Bankruptcy.*—Bankruptcy is the name applied to judicial proceedings by which a debtor may be discharged from his debts after his property has, by force of law, been taken into the custody of the court for distribution among his creditors. It is therefore not technically correct to apply the term bankrupt to one who is merely insolvent. No one is a bankrupt until he has been adjudged a bankrupt by a court upon which the legislature has conferred bankruptcy jurisdiction.

The Constitution gives Congress the power to pass a uniform bankruptcy law, and four different acts have been passed under this authority. The first three were short-lived, but the fourth and present act has been in force since 1898.[1] During the inter-

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[1]By the present Act, the United States district courts have been vested with jurisdiction over all bankruptcy proceedings.

The general orders and forms in bankruptcy established by the Supreme Court of the United States may be found in a pamphlet containing the Act and its amendments, which has been published by the Government Printing Office, Washington, D. C.

It is impracticable to consider in this treatise the administrative features of the Bankruptcy Law, comprising such topics as the procedure of the courts, the duties of the various officers, and the meeting of creditors.

vals in which this country was without a National Act only a few of the states had legislation amounting in effect to bankruptcy law.[2] These statutes are not abolished by the National Act, but are merely rendered inoperative as long as this act remains in force. The insolvency laws of most states do not attempt to enforce a compulsory sequestration and distribution of an insolvent's property and hence do not infringe upon the field covered by the National Bankruptcy Act. This type of state legislation is therefore not affected by the National Act.

The early English bankruptcy acts were applicable only to actual traders. All recent bankruptcy statutes, however, both in England and in this country, have abolished the distinction between traders and non-traders.

Two main purposes appear in all modern legislation on this subject: First, equal distribution among creditors; and second, the discharge of an honest debtor from provable claims, irrespective of the wishes of his creditors.

The present National Act is the outcome of a compromise between sharply divergent views. There has naturally always been a certain amount of dissatisfaction with it; nevertheless, there is apparently little likelihood of its repeal in the near future. Further amendments to the act may be advisable and it is to be hoped that creditors will take an increasingly active interest in the administration of bankruptcy estates in order that expenses may be diminished, dividends increased, and fraudulent practices be reduced to a minimum. Certain large associations of merchants, manufacturers, and credit men have standing committees for co-operation among creditors in case of a debtor's failure, and the work of these committees is an effective force in stamping out abuses in the administration of the bankruptcy act.

To an insolvent debtor the act affords an opportunity to

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[2]Since the name of bankruptcy was odious, these statutes were not called bankruptcy acts but were given the same name which is applied to every other variety of state legislation dealing with insolvent debtors, namely Insolvency Laws. According to its original signification this term was limited to statutes which discharged an insolvent debtor from imprisonment for debt on condition that he surrender his property for statutory distribution among his creditors, but left the future acquisitions of the insolvent liable for his old debts.

make a fresh start from the date on which he has been adjudicated a bankrupt, for it permits him to secure a discharge from all his provable debts (a boon seldom conferred by the legislation of the states).

Creditors find a very great advantage in the act in the fact that it operates uniformly throughout the whole country. They know from experience the serious inconvenience and confusion that attend settlements with insolvent debtors under the legislation of the several states—legislation which is bewildering in the diversity and variety of its provision. Apart from the general advantage of uniformity, the present act commends itself to creditors because it renders inoperative certain objectionable features that exist in the law of not a few states. Particularly disliked by the commercial classes are the preferences which some of the state laws give to resident creditors to the injury of non-resident creditors. The present act has the great merit of providing on broad lines for equality of distribution among all the creditors regardless of their places of residence, to the advantage of those whose business is interstate in character, or who do not maintain a "hair-trigger" credit department. It makes null and void all liens obtained through legal proceedings against an insolvent debtor at any time within four months prior to the filing of a petition in bankruptcy against him (unless the court shall order the lien to be preserved for the benefit of the estate).[3] The act therefore frees creditors to a great extent from the necessity of engaging in a frantic scramble for precedence and encourages co-operation among creditors which in many cases benefits the debtor as well, by making possible a satisfactory readjustment of his affairs without court proceedings.

The power of subjecting the debtor to a searching examination is one which can usually be exercised only in bankruptcy proceedings. A settlement out of court means comparative privacy with an attendant risk to creditors. Even the Insolvency Laws of most states fail to give creditors a free hand in investigating the debtor's past dealings. The Bankruptcy Act

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[3]Sec. 67, f.

owes much of its popularity among creditors to the fact that it gives them wide powers of examination and enables them publicly to unmask a debtor who has indulged in reprehensible business practices. It provides that the bankrupt must submit to an "examination concerning the conducting of his business, the cause of his bankruptcy, his dealings with his creditors and other persons, the amount, kind, and whereabouts of his property, and, in addition, all matters which may affect the administration and settlement of his estate."[4] The act further enacts that a court in bankruptcy may require any designated person, including the bankrupt's wife, to be examined concerning the acts, conduct, or property of the bankrupt "provided that the wife may be examined only touching business transactions by her or to which she is a party, and to determine the fact whether she has transacted or been a party to any business of the bankrupt."[5]

Another advantage of the act is the deterrent influence it exerts on debtors who are inclined dishonestly to conceal their property. The act makes it a crime punishable by imprisonment for a person knowingly and fraudulently to conceal, while a bankrupt, any of the property belonging to his estate in bankruptcy.[6]

The National Bankruptcy Law is applicable only to certain specific classes of insolvent debtors. The act makes important distinctions in this respect between voluntary and involuntary proceedings.

With reference to proceedings instituted on the initiative of the debtor it states that "any person except a municipal, railroad, insurance, or banking corporation, shall be entitled to the benefits of this act as a voluntary bankrupt."[7]

In the case of proceedings instituted on the initiative of the creditors, however, there are certain additional exceptions which probably owe their existance to considerations of political expediency. The language of the act is as follows: "Any natural

[4]Sec. 7, a, 9.
[5]Sec. 21, a.
[6]Sec. 29, b.
[7]Sec. 4, a.

person, except a wage-earner[8] or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed business, or commercial corporation, except a municipal, railroad, insurance, or banking corporation, owing debts to the amount of one thousand dollars or over, may be adjudged an involuntary bankrupt upon default or an impartial trial, and shall be subject to the provisions and entitled to the benefits of this act.[9]

It should be observed that the act has no application to the estates of decedents.

A debtor who wishes to institute voluntary proceedings files his petition in the District Court of the United States, which is the bankruptcy court, asking to be declared a bankrupt. After an immediate hearing either a decree that he is adjudged a bankrupt or a dismissal of his petition takes place forthwith.

In the case of involuntary proceedings the procedure must be as follows: "Three or more creditors who have provable claims against any person which amount in the aggregate, in excess of the value of securities held by them, if any, to five hundred dollars or over; or if all of the creditors of such person are less than twelve in number, then one of such creditors whose claim equals such amount may file a petition to have him adjudged a bankrupt.[10]

A petition filed for the purpose of having a debtor adjudged a bankrupt must comply with three requisites. With respect to the commencement of involuntary proceedings the act provides as follows: "A petition may be filed against a person who is insolvent and who has committed an act of bankruptcy, within four months after the commission of such act."[11] As regards these requisites it is necessary to consider the significance of the word "insolvent" and the phrase "act of bankruptcy" and "four months after the commission of such act."

According to the common-law definition, mere cessation of

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[8]A wage-earner is defined in the Act as "an individual who works for wages, salary, or hire, at a rate of compensation not exceeding one thousand five hundred dollars per year" (§1, a, 27).

[9]Sec. 4, b.

[10]Sec. 59, b.

[11]Sec. 3, b.

payments or inability on the part of a debtor to pay his debts as they mature, constitutes insolvency. This definition is harder on the debtor than the definition incorporated into the Bankruptcy Act, which is: "A person shall be deemed insolvent within the provision of this act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts."[12] Nevertheless, whenever there is a jury trial on the question of insolvency, the jury may ordinarily be counted on to render a verdict of insolvency if the debtor's inability to pay is evidenced by an unsatisfied judgment against him for current obligations.

The present law specifies five acts of bankruptcy, and these in involuntary proceedings are the only grounds upon which an insolvent debtor may be adjudged a bankrupt. What is necessary to constitute each of these acts of bankruptcy is the subject of consideration elsewhere;[13] it is sufficient in this connection merely to enumerate them. "Acts of bankruptcy by a person shall consist of his having:

First, conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them; or

Second, transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or

Third, suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or final disposition of any property affected by such preference vacated or discharged such preference; or

Fourth, made a general assignment for the benefit of his

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[12]Sec. 1, a, 15.

[13]Fraudulent conveyances are discussed in §269; preferences in §§266, 269; general assignments in §266; receiverships in §268. The fifth act of bankruptcy requires no comment.

creditors, or being insolvent, applied for a receiver or trustee for his property, or because of insolvency a receiver or trustee has been put in charge of his property under the laws of a State, of a Territory, or of the United States; or

Fifth, admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.''[14]

The execution of a general assignment for the benefit of creditors is an act of bankruptcy irrespective of the debtor's solvency, and the first and fifth acts of bankruptcy may also be committed even though the debtor be solvent at the time. On the other hand, insolvency is a necessary element in the second and third acts of bankruptcy, and the appointment of a receiver of the debtor's property is not an act of bankruptcy unless the appointment be made on the ground of the debtor's insolvency.

If insolvency at the time of the filing of the petition be proved by the alleged bankrupt, this furnishes a complete defense to a petition alleging the first act of bankruptcy.[15] But despite the language used in section 3, b, it has been held that an allegation of solvency at the time of the proceeding is not a sufficient answer to a petition based on the making of a general assignment for the benefit of creditors, or a written admission of inability to pay debts and willingness to be adjudged a bankrupt on that ground.

There is a third condition which must be complied with in order to maintain involuntary proceedings. This is in effect a statute of limitations. The act provides that the petition against a debtor who has committed an act of bankruptcy must be filed ''within four months after the commission of such act.'' Directions are also given as to how this period is to be computed. The time limit does not expire, in case of fraudulent conveyances, preferences, or assignments until four months after the date of the recording or registering of the transfer ''if by law such recording or registering is required or permitted, or, if it is not, from the date when the beneficiary takes notorious, exclusive, or continuous possession of the property unless the petitioning

[14]Sec. 3, a.
[15]Sec. 3, c.

creditors have received actual notice of such transfer or assignment.''[16]

A fraudulent conveyance is an act of bankruptcy. Apart from any bankruptcy statute, a fraudulent conveyance may be attacked by judgment creditors. The conveyance being regarded as void, a creditor upon obtaining judgment against the fraudulent grantor, may levy execution on the property conveyed, or if he prefers, he may in many, although not all, states immediately invoke the aid of equity even when his remedy at law is entirely adequate, and have the fraudulent conveyance set aside.

The Bankruptcy Act affords still another remedy to creditors in such a case. The first of the five prescribed ''acts of bankruptcy'' consists in the debtor having ''conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them.'' Although there is a certain amount of diversity in the rules that prevail in the several states as to what constitutes a fraudulent conveyance, Congress has not attempted to alter this condition by the enactment of definite rules. Hence, in deciding whether or not property has been ''conveyed'' or ''transferred'' in fraud of creditors, the bankruptcy court takes the law of each state as it finds it. In addition, the concealment or removal of the debtor's property with intent to hinder, delay, or defraud creditors (transactions which are not technically fraudulent conveyances) are specifically embraced within the definition of the first act of bankruptcy.

Preferences are acts of bankruptcy whether they consist of a transfer of property or of an adverse judgment. The law of fraudulent conveyances does not invalidate a bona fide transaction which is supported by a consideration, even though it it be a past consideration. Nor is there any other doctrine of the common law which forbids a debtor from paying any one of his creditors to the exclusion of others. Preferences, however, are plainly opposed to the principle of equality of dis-

[16] Sec. 3, b.

tribution which is perhaps the most characteristic principle of modern bankruptcy legislation.

The second act of bankruptcy consists of a transfer of property made by an insolvent person to a creditor with intent to prefer the transferee over other creditors. This act of bankruptcy may be committed without any knowledge on the part of the creditor of the debtor's intent to prefer him. On the other hand, the language of the Act requires that the insolvent person have an "intent to prefer." The existence of such an intention is purely a question of fact. The decisions take the eminently practical point of view that a debtor must be presumed to intend the natural consequences of his act. If he knows of his insolvency,[17] and if the inevitable result of the transaction is to create a preference as defined in the Act, the "intent to prefer" will be conclusively presumed. He cannot ward off involuntary proceedings even though he paid an antecedent debt under pressure or constraint. It is, therefore, by no means always easy for one who knows himself to be insolvent to avoid committing this act of bankruptcy. He can hardly refrain from giving some advantage to the most insistent of his creditors over the other creditors if he makes any struggle at all to avert the impending financial crisis.

Another class of preferences are specified as the third act of bankruptcy. These are the preferences obtained through legal proceedings which result in diverting any of the property of the insolvent debtor from his creditors. This kind of preference constitutes what has aptly been termed the passive act of bankruptcy, inasmuch as it is the only one which requires no action on the part of the debtor.[18] Sheer helplessness on his part is an immaterial factor.

If during the debtor's insolvency, the creditor has acquired a lien upon property of the debtor through legal proceedings,[19]

[17]There is a presumption, although a rebuttable one, that where the fact of insolvency exists the debtor knows of it.

[18]This act of bankruptcy is, of course, also committed if the debtor aids or colludes with his creditor in the legal proceedings.

[19]All liens obtained by legal proceedings valid under the state laws are within the provision; for example, whether a judgment constitutes "a preference through legal proceedings" will depend on whether the local law makes a judgment a lien on real estate of the judgment debtor.

the enforcement of which will enable him to obtain a greater percentage of his debt than other creditors of the same class, the mere failure of the debtor to vacate or discharge the lien out of which the preference arises, may make him subject to adjudication as a bankrupt. To have this effect, however, the act provides that the insolvent debtor's failure to vacate or discharge a preference through legal proceedings, must continue until "at least five days before a sale or final disposition of any property affected by such preference."

As a consequence of the provisions of the Act relating to preferences, it is practically impossible for an insolvent debtor who owes debts to the amount of $1000 or over and who has any assets at all, to escape the stigma of being adjudicated a bankrupt except through the indulgence of his creditors.

A preference is voidable if the person receiving it has reasonable cause to believe that the transaction amounts to a preference. No question in the administration of a bankrupt estate is more important than the position of the creditors who have received preferences.

The Act divides preferences into two classes and defines them as follows: "A person shall be deemed to have given a preference if, being insolvent, he has within four months before the filing of the petition, or after the filing of the petition and before the adjudication, (1) procured or suffered a judgment to be entered against himself in favor of any person, or (2) made a transfer of any of his property, and the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class." [20]

The object aimed at by the Bankruptcy Act is equality of distribution of the property which the bankrupt owned four months before the filing of the petition in bankruptcy against him. To this end, after defining a preference, the Act provides that every judgment or transfer operative as a preference after

[20]Sec. 60, a. This subdivision also makes the following definite provision regarding the four months' period: "Where the preference consists in a transfer, such period of four months shall not expire until four months after the date of the recording or registering of the transfer, if by law such recording or registering is required."

the commencement of the four months' period shall be voidable by the trustee and he may recover the property or its value if the person receiving it or to be benefited thereby had "reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference."[21]

This provision for the recoverability of preferences is important only as regards a preferential "transfer." Where the debtor "procured or suffered a judgment to be entered against himself in favor of any person" the situation is governed by the provision of the Act relating to the annulment of outstanding judicial liens. Under the latter provision "all levies, judgments, attachments, or other liens, obtained through legal proceedings against a person who is insolvent, at any time within four months prior to the filing of a petition in bankruptcy against him, shall be deemed null and void in case he is adjudged a bankrupt, and the property affected by the levy, judgment, attachment, or other lien shall be deemed wholly discharged and released from the same, and shall pass to the trustee as a part of the estate of the bankrupt.[22]

With reference to the position of the creditor when the preference consists of a "transfer," it is to be observed that the requirement "reasonable cause to believe" that the effect of the transfer would create a preference, makes it plain that a preferential transfer which may constitute an act of bankruptcy, is not always avoidable by the trustee in bankruptcy. On the other hand, although to render the transfer an act of bankruptcy the debtor must intend a preference,[23] after an adjudication of bankruptcy the intent of the debtor in making the transfer and the creditor's belief as to his intent are both immaterial in determining whether the preferential transfer is voidable. In the latter case the inquiry is directed solely to the significance which would be attributed to the transfer by a creditor of ordinary sense and prudence.

It should not be overlooked that in the administration of a bankrupt estate a preferential transfer is not treated as a wrong-

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[21]Sec. 60, b.
[22]Sec. 67, f.
[23]Sec. 3, a, 2.

ful act unless the preference was effected within four months prior to the filing of the petition in bankruptcy, except in the case of a transfer of the kind which the state law requires to be recorded. In the last-named situation the Act stipulates that "such period of four months shall not expire until four months after the date of the recording or registering of the transfer." Of course there are commonly many dealings by an insolvent person within the time limit of four months of a sort which do not amount to a preference. No transfer of property or of money can be attacked by the trustee if it was made upon a present and adequate consideration. Moreover, instead of strictly applying the percentage test prescribed in the Act's definition of a preference, the courts in many cases seem actually to proceed upon the assumption that in order to give a preference, the failing creditor must enter into a transaction which results in a depletion of his assets. It is held, for example, that if he pays current bills for rent, power, and the like, such payments do not constitute preferences, although these creditors receive a greater percentage of their debts than the other creditors of the same class. The theory is that inasmuch as payments of this kind preserve the business as a going concern, they do not diminish the estate.

Proof of claims and the order of their payment are regulated in detail by the bankruptcy act. The bankrupt estate consists of all the property, both tangible and intangible, of the bankrupt except that which is exempt by state laws. These properties are vested in the trustee by operation of law as of the date of the adjudication.[24] They are held by the trustee free from all attachment or judgment liens secured by creditors within four months prior to the filing of the petition. As was stated in the foregoing pages, preferential transfers are, under certain circumstances, voidable and the property recoverable by the trustee. In addition, the trustee may avoid any fraudulent conveyance which any creditor might have avoided, even though no creditor has acted and more than four months has elapsed since the fraudulent conveyance was made.[25]

[24]Sec. 70, a.
[25]Sec. 70, e.

With regard to exempt property the Act provided as follows: "This Act shall not affect the allowance to bankrupts of the exemptions which are prescribed by the state laws in force at the time of the filing of the petition in the state wherein they have had their domicile for the six months or the greater portion thereof immediately preceding the filing of the petition.[26]

The debts which may be proved against the bankrupt estate are specifically defined by the act.[27] Among them are, of course, those founded upon an open account or upon a contract expressed or implied. So also any debt is a provable claim if it is a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owed at the time of the filing of the petition. Furthermore, if at that time there are matured claims, they are provable even though unliquidated, for instance where the bankrupt has broken a contract but the amount of damages arising therefrom has not been judicially assessed at the time the bankruptcy petition was filed. As to this sort of unliquidated claims against the bankrupt, it is provided that these "may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against this estate."[28] Contingent debts and liabilities, that is, those which will be absolutely owed only in case of a certain contingency occurring after the bankruptcy, should also be provable, whenever they are capable of being fairly valued, according to the broad policy of bankruptcy statutes; otherwise the bankrupt fails to get the full benefits of discharge. The present Act, however, unfortunately fails to include an express provision for the proof of such claims. Various Federal courts have passed on the question, but the decisions are not at all uniform. It is regrettable that there is still uncertainty in some of these courts as to whether a claim is provable in certain common situations, for instance when the claim is based on the bankrupt's endorsement of a negotiable instrument which has not matured at the date of bankruptcy. It is to be hoped that the general question of the provability of a contingent claim in a proper case will

[26]Sec. 6, a. On the nature of these exemptions, see §246, *supra.*
[27]Sec. 63, a.
[28]Sec. 63, b.

soon be presented to the Supreme Court for an authoritative ruling.

Proof of claims is refused to all creditors, as a rule, after one year from the adjudication.[29] There are, moreover, wholesome restrictions as regards the allowance of claims of certain classes of creditors. The Act states that creditors who have received invalid preferences, that is, preferences which are voidable by the trustee, or who have been parties to transfers voidable because in fraud of other creditors, shall not have their claims allowed "unless such creditors shall surrender such preferences, conveyances, transfers, assignments, or incumbrances."[30] Somewhat more doubtful as a matter of policy is the provision relating to the allowance of the claim of a secured creditor. When a creditor has obtained security from the debtor which he may lawfully retain, he is not allowed (unless he surrenders the security to the trustee, in which case the claim is allowed to the full amount), a dividend except for the amount of his claim after deducting the amount of the security.[31]

Certain debts have priority in the distribution of the bankrupt estate. The order of payment of these debts is as follows: taxes; the actual and necessary cost of preserving the estate subsequent to filing the petition; filing fees paid by creditors in involuntary proceedings; the cost of administration, including certain specified reasonable attorneys' fees; "wages due to workmen, clerks, or servants which have been earned within three months before the date of the commencement proceedings, not to exceed three hundred dollars to each claimant;"[32] and "debts owing to any person who by the laws of the states or the United States is entitled to priority."[33]

The grant of a discharge in bankruptcy is subject to a variety of conditions and restrictions. While bankrupts as a class are no longer treated as criminals, certain bankrupts are deemed unworthy of a discharge from their debts. Moreover, certain

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[29]Sec. 57, n.
[30]Sec. 57, g.
[31]Sec. 57, h.
[32]Sec. 64, b, 4.
[33]Sec. 64, b, 5.

kinds of debts are made continuing liabilities for all bankrupts on grounds of public policy.

A bankrupt is deemed unworthy of discharge if he has "(1) committed an offense punishable by imprisonment as herein provided; or (2) with intent to conceal his financial condition, destroyed, concealed, or failed to keep books of account or records from which such condition might be ascertained; or (3) obtained money or property on credit upon a materially false statement in writing, made by him to any person or his representative for the purpose of obtaining credit from such person; or (4) at any time subsequent to the first day of the four months immediately preceding the filing of the petition transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed, any of his property, with intent to hinder, delay, or defraud his creditors; or (5) in voluntary proceedings been granted a discharge in bankruptcy within six years; or (6) in the course of the proceedings in bankruptcy refused to obey any lawful order of, or to answer any material question approved by the court."[34]

There are certain debts which public policy requires to be paid or which are grounded in fraud or moral misconduct against which Congress has expressly refused to relieve a bankrupt. Debts of this description are those which "(1) are due as a tax levied by the United States, the state, county, district, or municipality in which he resides; (2) are liabilities for obtaining property by false pretenses or false representations, or for wilful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; or (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity."[35]

[34]Sec. 14, b.
[35]Sec. 17.

At common law any creditor who refuses to join in the composition, of course, retains his rights against the debtor, whether the settlement by composition is effected by the mere agreement of the parties, or is subject to a special statute which may govern these proceedings. On the other hand, the Bankruptcy Act of 1898 has a special provision whereby the judge may order that terms of composition offered by the bankrupt be confirmed, the confirmation discharging the bankrupt from all his debts other than those which would not be affected by a discharge in bankruptcy.[36] The act stipulates that after the bankrupt's offer of terms of composition has been accepted in writing by a majority in number of all creditors whose claims have been allowed, which number must represent a majority in amount of such claims, he may apply to the court for a confirmation of the composition. After a hearing on this application, it is the duty of the judge to confirm the composition if satisfied that (1) it is for the best interests of the creditors; (2) the bankrupt's conduct has not been such as to constitute a bar to his discharge; and (3) the offer and its acceptance are in good faith.[37] Upon the confirmation of a composition offered by a bankrupt, the title to his property revests in him. By regaining his property, especially if it consists largely of assets used in business, the debtor has a better opportunity to rehabilitate himself financially, and this is the basis of his appeal to his friends for the financial assistance necessary to effect the composition. On the other hand, such an arrangement is frequently also beneficial to his creditors whenever the debtor's property is of the kind which would not realize a fair sum if sold under a hurried sale in bankruptcy proceedings.

§268. *Receiverships of Insolvent Corporations.*—A court of equity may in its discretion appoint a receiver for an insolvent corporation. Equity's primary jurisdiction is *in personam,* and it follows, therefore, that equity has no inherent jurisdiction over the title to property. As regards the possession of property, however, equity in a proper case exercises an unchallenged jurisdiction.

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[36]See Sec. 12 and Sec. 14, c.

[37]Sec. 12.

A receiver is an officer of a court of equity, appointed by, and acting under the immediate control of the court. This court may appoint a receiver under supplementary proceedings in aid of execution when a judgment creditor is unable to satisfy his judgment by execution at law. Such a receiver is generally known in this country as a receiver under a creditor's bill. On the other hand, a so-called equitable receiver is appointed for the purpose of taking temporary possession of property which is subject to conflicting claims, and is in danger of destruction or material injury during the pendency of the litigation.[1] The subsequent discussion will deal only with this type of equitable receivership.

The power of sequestering private property and of placing it entirely within the control of the court is a radical remedy, and one which should always be exercised with circumspection. A receivership is therefore never a matter of right; it always rests in the sound discretion of the court. But this discretionary jurisdiction is subject to certain general rules. In the first place, the appointment of a receiver is usually held to be merely an incidental and auxiliary remedy for the attainment of some other definite lawful object which is within equity's primary jurisdiction; the appointment of a receiver must not be the sole object of the suit. Furthermore, since a receivership affects the possession of property, the court will usually refuse to entertain a petition for this remedy except upon the application of one who has a claim to the property. Again, before the court will apply this extreme remedy it requires affidavit evidence, and, in all but cases of the most stringent necessity, it acts only after all

[1]Some of the states have a considerable body of statutory law on the general subject of receiverships, especially in regard to receivers after dissolution of a corporation. These statutory receivers are liquidators who by statute are usually vested with the title to the property of the dissolved corporation, and often have statutory powers and duties.

The National Banking Laws contain provisions for the appointment of receivers of national banks.

The National Bankruptcy Act (sec. 2, clause 3), invests the courts of bankruptcy with jurisdiction to appoint receivers "in case the courts shall find it absolutely necessary, for the preservation of estates, to take charge of the property of bankrupts after the filing of the petition and until it is dismissed or the trustee is qualified."

the parties in interest have had an opportunity to be heard. Finally, the court must be convinced by the evidence that a receivership is really necessary to preserve the property in question against threatened or anticipated injury pending litigation as to the rights of the parties.

The situations which lead to the appointment of an equitable receiver are numerous and varied, whether the property belongs to individuals, partnerships, or corporations. The most important class of receiverships are, however, receiverships for corporations. In the great majority of cases the necessary prerequisites for the appointment of receivers of a corporation are the direct result of acute financial difficulties on the part of the corporation.[2] The subsequent discussion will be confined to receivership proceedings against financially embarrassed corporations.

Business policy is generally the determining factor in the appointment of an equitable receiver for an insolvent corporation. In the absence of statutory authority equity will not appoint receivers for an insolvent corporation merely on the ground of the corporation's insolvency. A bill in equity must ask for some other proper final relief and request the appointment of receivers as a merely ancillary remedy.

A case of this kind is presented by a judgment creditor's bill which was referred to in the preceding section. In such a suit a judgment creditor whose execution issued upon the judgment has been returned unsatisfied, files a creditor's bill for the purpose of satisfying his debt out of assets of the corporation which are not liable to levy and sale under an execution at law. In aid of such a "bill to reach and apply," as it is sometimes called, a court of equity will, if necessary, appoint a receiver who will take charge of the corporate property, collect the debts due the corporation, and apply them to the payment of the judgment.

Another situation in which the appointment of receivers is ancillary to other equitable relief is when foreclosure proceed-

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[2]Even a solvent corporation may be placed in charge of receivers. This, however, is not a frequent occurrence inasmuch as courts very properly refuse to interfere with the management ot a corporation unless there is clear proof that its assets are being placed in jeopardy by the gross mismanagement or fraud of its officers, or by a violation of the charter rights of the minority stockholders.

ings are brought in equity on behalf of bondholders whose bonds are in default. The bill to enforce the security of the bondholders frequently includes a petition for the appointment of receivers to prevent the impairment of the security which is alleged to be imminent if the mortgagor be permitted to remain in possession of the property.

Frequently, however, receivers are appointed in connection with a creditors' administration bill. Equity has jurisdiction to enforce compulsory liquidation of an estate whenever there exists a limited fund which is insufficient to take care of all claims against it, or which will be dissipated if creditors are permitted to take advantage of the principle of "first come, first served." This administrative jurisdiction of an equity court is today most commonly exercised over insolvent corporations. A judgment creditor who files a bill for this purpose does so for the benefit of all creditors and in administering the property of the corporation the court of equity makes a ratable distribution of the assets among all creditors entitled to share in them. As an incident to the general administration of the insolvent corporations property equity usually takes possession of the corporate assets and appoints receivers.

It would be highly advantageous, of course, to avoid the expense, delay and uncertainty which are incident to a receivership. The only alternative, however, is to procure a voluntary readjustment of the corporate finances through the assent of the various classes of creditors and security holders. This mode of settling the corporation's debts and rearranging its capital structure and of rehabilitating its credit requires the prompt cooperation of all interested parties in a scheme of general compromise. In the case of a corporation with a large number and variety of creditors and security holders the practical difficulties of effecting a financial reorganization by means of mutual concessions made outside of court proceedings are almost insuperable.[3]

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[3]During 1915 several notable attempts were made to readjust the finances of failing railroad corporations by means of a reorganization outside of the courts, but in the end it became necessary to resort to receiverships and to place the properties in charge of the courts. See also James N. Rosenberg, *The Aetna Explosives Case*, 20 Col. Law Rev. 733.

Business considerations of this kind have, in modern times, led to a marked and rapid extension of receivership law in this country, particularly with respect to railroads and public service corporations which are excepted from the provisions of the National Bankruptcy Act. "Indeed, in no other branch of equity jurisprudence has there been such an adaptation of equitable principles to the requirements of commercial advancement."[4] A most important development is the facility with which a receivership is today precipitated by a creditor who is friendly to the corporation and whose action is taken with its acquiescence and for its benefit. Sometimes the suspicion is justified that the real object of such a "friendly receivership," as it is called, is not the avowed object of liquidation but the breathing spell it gives the corporation in its effort to work out of its difficulties.

"Friendly Receiverships" are one of the most striking developments of modern receivership law. If a friendly creditor asks for a receivership in aid of a creditors' administration bill brought by him against the corporation, and the corporation in its answer admits its insolvency and its willingness to have receivers take charge of its affairs, it is generally assumed without question that sufficient grounds exist for a receivership.

Moreover, the practice has grown up particularly in the case of railroads and public service corporations, to grant the remedy even at the instance of a simple contract creditor, that is, one who has not reduced his claim to a judgment, and so, of course, has no lien of any kind whatsoever upon the property of the corporation.[5]

For various reasons it is usually desirable to institute receivership proceedings in a United States court in preference to a state court. This procedure is practicable in nearly every case, for it is usually possible for the corporation to induce one of its

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[4] *Penn. Steel Co. v. N. Y. City Ry. Co.* (1912), 198 Fed. 721, 736, per Noyes, J.

[5] See, for example, *Re Metropolitan Railway Receivership* (1908), 208 U. S. 90.

"And now that which was formerly regarded as the essential thing —the judgment—is unnecessary unless the corporation objects. Thus is illustrated anew the vainness of saying what the courts of equity *cannot* do." *Penn Steel Co. v. N. Y. City Ry. Co., supra,* at 737.

non-resident creditors to begin the proceedings in a United States court.

The modern developments in this branch of equity jurisdiction are defended on various grounds. In the case of a corporation which is a common carrier or a public utility company the interests of the public imperatively demand the maintenance of the unity of the system and its continuous and continued operation, and this feature has been emphasized in certain decisions in which courts have appointed receivers of businesses of this nature. A few courts have even appointed receivers for railroad corporations in financial difficulties where the receiver was frankly the only relief sought.[6] As to all other kinds of corporations it is not regarded a cause for the appointment of receivers that a receivership would hold an umbrella over the corporation to protect it from an impending but supposedly temporary financial storm; if all that is really aimed at appears to be an "umbrella receivership," a court of equity declines jurisdiction.

The recent growth of the law relating to receivers is an encouraging proof that equity has not lost all of its original flexibility and still has a capacity to meet the exigencies of modern business. The pressure of business facts makes it appropriate to grant a palliative remedy which will insure at least the temporary preservation of the corporate property and organization, and indeed as a practical matter, often making it possible to settle the corporate debts without entailing the dissolution of the corporation.

Any benefits which accrue to the creditors and security holders of a complicated and highly organized business by the prevention of a needless destruction of values, cannot fail to be advantageous to the general public as well.

There have unfortunately, however, been instances in which the far-reaching remedy of a receivership has been employed in

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[6]Instances are not unknown in which a court of equity has gone so far as to appoint receivers for a railroad upon a bill filed by the railroad itself. See *Central Trust Co. v. Wabash Ry. Co.* (1886), 29 Fed. 618. *U. S. Trust Co. v. Wabash, etc., Ry. Co.* (1903), 150 U. S. 287. This procedure, however, has met with much criticism.

furtherance of purposes which were not at all legitimate. For instance, a street car system in a large western city was once put in charge of receivers in order that any strikers who might interfere with its operation would be committing an offense against the court which had the custody of the property and thus become subject to the penalties of contempt of court. Again, in 1915, it was stated in a report of the Interstate Commerce Commission on the affairs of a large railroad system, that the court action resulting in the appointment of receivers of the railway was "not a bona fide proceeding to collect a debt, but one instituted to carry out the purposes and schemes of the syndicate controlling the railway." Abuses of this kind are greatly to be deplored inasmuch as they create popular distrust of this highly useful remedy which in the great majority of cases has been applied with wise discretion and been made to subserve a really proper purpose.

§269. *Transactions in Fraud of Creditors.*—It is possible for a debtor to violate the rights of some of his creditors by merely making a contract, and this may be true even if the contract expressly stipulates that it is not to involve any of the property then owned by the debtor. For instance, it is a fraud upon a creditor who is a party to a composition agreement for the debtor to make a secret contract with any other creditor whereby the latter is promised more than his *pro rata* share as an inducement for him to join in the composition. A composition agreement which provides for a *pro rata* payment to all of the creditors entitles each creditor to assume that all of the creditors are to be treated alike, and hence the preference may be said to be fraudulent as to him if he was ignorant of it. The law, therefore, permits him, upon discovering the facts, to disregard the release he gave and to sue for the unpaid balance of his original claim.

The most serious injury to a creditor results from improper transfers of property belonging to his debtor, and it is transactions of this kind which are now to be discussed. The subject of conveyances in fraud of creditors is one of practical importance, even in the absence of bankruptcy proceedings, and an act to make uniform the law on this topic has recently received the

approval of the National Conference of Commissioners on Uniform State Laws.

A transfer of property by one who is indebted, with a view to "hinder, delay, or defraud" his creditors was probably voidable at common law. Any doubt on this point, however, was definitely removed in England by a statute.[1] The principles of this statute are now recognized as law even in those states in which the matter has not been dealt with by legislation.

That the public policy which finds expression in the statute of 13 Eliz. c. 5 is really imbedded in the common law system is confirmed by the numerous decisions which hold that certain transfers are voidable by creditors on the ground of "constructive fraud" or "legal fraud." The statute in terms applies only to conveyances made with "intent" to "hinder, delay, or defraud," yet courts have declared certain conveyances fraudulent irrespective of the actual intent of the debtor. Whenever the inevitable consequence of a course of dealing by the debtor with respect to his property is actually to hinder, delay, or defraud his creditors, "the intent to do so will be presumed."[2]

A typical case of such a transfer is presented whenever a debtor makes himself insolvent by giving away his property.[3] It matters not that such a debtor's action was prompted by a keen sense of his responsibility to his wife or his child; the law insists that he must be just before he can be generous. It may be true as Emerson says, that it is always so pleasant to be generous, though very vexatious to pay debts. The law, however, has little sympathy with such a point of view.

Often a debtor who is insolvent makes payments on life insurance policies of which his wife is the beneficiary. In *The Merchants' and Miners' Trans. Co. v. Borland*,[4] it was said by Pitney, V. C.: "There is no mystery or charm about life insur-

[1]St. 13 Eliz., c. 5 (1570).

[2]"Whether a transaction be fair or fraudulent is often a question of law; it is the judgment of law upon facts and intents." Lord Mansfield in *Worseley v. Demattos* (1758), 1 Burr, Part IV. 467, 474.

[3]In a few states it is even held that a gift of property by one who is indebted is conclusively fraudulent as against existing creditors irrespective of the financial condition of the debtor at the time. Fortunately this extraordinary doctrine is probably not law today anywhere except in Ala., Ky., Mich., N. J., S. C., and Va.

[4](1895) 53 N. J. Eq. 282.

ance. . . . The case presented, then, is this: A debtor owing a large sum of money upon a judgment, and plainly insolvent, is in receipt from some source, each year, of money and means belonging to himself, over and above what he finds necessary or proper to expend for current expenses, to the amount of about $1,500, and instead of devoting it to the payment, *pro tanto,* of his debt, he makes a present of it to his wife and children by the machinery of divers polices of life insurance, with the result that, at his death, he has given his wife in premiums enough to pay his debt, and she has become practically rich at the creditor's expense. This statement of the case seems to me to decide it. . . . I am unable to discover any principle or well-considered authority upon which such a transaction can be sustained against creditors.''[5]

Situations exist in which the transaction is ''constructively fraudulent'' even though the debtor receives value for the assets he has transferred. Thus, it is general law that a transfer by an insolvent debtor is voidable if the only consideration received by him is a promise of support. An insolvent debtor is not permitted to secure for himself a purely personal benefit at the cost of stripping himself of assets which could have been used to satisfy the claims of creditors.

Another instance of a transfer of assets by way of a sale which will be set aside irrespective of the debtor's actual intent is a sale by an insolvent debtor of all his property to a corporation organized and controlled entirely by him for that purpose. If such a transaction were allowed to stand, it would prevent a seizure and sale of the debtors' tangible assets; and its necessary effect would be to hinder and delay creditors. Hence, it carries ''its death-wound upon its face,'' and is voidable as against existing creditors even if the insolvent or failing debtor acted openly.

The foregoing transactions are exceptional in character; the general rule is that a transfer for a consideration can be im-

[5]Some courts refuse to give creditors the entire proceeds of the policy, and today most states have statutes which grant relief of varying degrees of generosity to the beneficiary of the policy. In many states this legislation fixes the amount which the husband may annually set aside, as against his creditors, for the payment of the premiums on policies in favor of his wife.

peached by creditors only upon proof of an actual intent to defraud them. Although there is an aphorism to the effect that "it is trite law that the thought of man is not triable, for even the devil does not know what the thought of man is,"[6] the law certainly makes intention of decisive importance in more than one situation. The right to sell one's property is about as absolute as any legal right, yet in the case of a sale of property by a debtor, an intention of placing the property beyond the reach of creditors is generally a sufficient ground for invadidating the transaction on the initiative of creditors.

Actual fraudulent intent is an issue of fact. Generally, of course, only circumstantial evidence is available to prove it. The "marks" or "badges" of fraud are of many varieties and the degree of weight which is to be attached to any one of them always depends upon all the facts of the case. Courts prudently refrain from making an avowedly complete enumeration of the facts which are calculated to throw suspicion on the transaction. The following list of suspicious circumstances is given only for illustrative purposes: transfer of all the debtor's property; sale of stock and fixtures in bulk by an insolvent debtor;[7] secrecy of the transfer, as for example, agreement to withhold a chattel mortgage from record to protect the mortgagor's credit and enable him to get on his feet; conveyance absolute in form but intended as mere security; retention by the seller of possession of the goods sold;[8] sale on a long and unusual

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[6]From a judgment of Brian, C. J., cited by Lord Blackburn in *Brogden v. Metropolitan Ry. Co.* (1877), L. R. 2 App. Cas. 666, 692.

[7]In recent times, many states have passed Sales in Bulk Acts which provide that a sale of merchandise in bulk by a dealer is *prima facie* fraudulent, unless the sale be recorded or notice be given to creditors.

[8]In a number of states it is held that a sale of goods unless accompanied and followed by an actual change of possession is conclusive evidence of fraud and void as against the vendor's bona fide creditors (or purchasers). The decisions and statutes relating to the requirement of delivery of possession and the effect of the vendor's retention of possession are far from uniform, and it is impracticable in this text to attempt a detailed statement of the peculiarities and refinements in the rules of the several states. As regards the rights of creditors, the Uniform Sales Act merely provides that "where a person having sold goods continues in possession of the goods, or of negotiable documents of title to the goods, and such retention of possession is fraudulent in fact or is deemed fraudulent under any rule of law, a creditor or creditors of the seller may treat the sale as void." (Uniform Sales Act, §25.)

credit; inadequacy of consideration; insolvency or heavy indebtedness of the grantor; expectation or pendency of a suit; transfer made immediately before embarking upon a hazardous business or transaction involving risks exceeding the grantor's remaining assets.

Any single one of the foregoing facts may be suspicious enough to call for an explanation to say the least; some of them are treated by certain courts as involving an "irrebuttable presumption of fraudulent intent." Increased weight often attaches to these factors if the grantor and grantee are husband and wife, or stand in any other relation that binds them together in a community of interest, or offers unusual facilities for the perpetration of fraud upon creditors.

But proof of actual fraud on the part of the grantor does not in every case enable the injured creditors to avoid the fraudulent transfer. Creditors have but one argument for claiming the property which has been transferred to another, namely, that common fairness entitles them to it. Obviously, however, the argument is applicable whenever the property has passed to a purchaser who has acted in good faith and has paid the full consideration called for by the bargain.[9]

On the other hand, even a transfer for value is voidable by the creditors if it is made with a fraudulent purpose which is shared by the grantee as well as the grantor. Generally, the intent of the buyer, like that of the seller, is merely a matter of inference from all the surrounding circumstances, and each particular case, therefore, stands on its own footing.

Whenever the evidence indicates an actual mutual intent to defraud either existing or subsequent creditors, or both classes, any of the members of these respective classes may have the conveyance set aside. In addition, it is held by some courts, although not by all, that a transaction in which there is an actual intent to defraud existing creditors is also invalid as against subsequent creditors. In general, however, subsequent

[9] A marriage settlement between husband and wife, if entered into before marriage, is supported by the consideration of marriage and is, therefore, unimpeachable by creditors unless both parties concurred in the intended fraud upon creditors.

creditors have fewer rights than existing creditors, and it is necessary for them to prove actual and not merely constructive fraud as to themselves. Neither the fraudulent debtor, nor any person in *pari delicto* is entitled to avoid a fraudulent conveyance. The law does not give one who has participated in the fraudulent intent any help whatsoever with reference to the transaction. The dishonest grantor is without a remedy if the grantee proves to be an unreliable confederate.[10] Similarly, the unscrupulous grantee will fail if he should sue for reimbursement from his grantor after the transaction has been set aside by creditors. The law leaves fraudulent parties where it finds them.

In a few situations a transfer of assets with intent to defeat creditors is not a voidable transaction. One instance in which it is generally held that a transfer of assets is valid in spite of an intent to defeat creditors is a transfer which results in securing property which is exempt from seizure by creditors in exchange for property which is not exempt. "He takes from his creditors by this action nothing in which they have any vested right. The constitution or statute exempting the homestead from the judgments of creditors is in force when they extend the credit to him, and they do so in the face of the fact that he has this right."[11]

Again, the child's duty of service during minority is not an asset which is available to creditors of the parent. "A creditor cannot make his debtor work in order to pay the debt, nor can he force him to make his children work."[12] When, therefore, a parent relinquishes his rights to the earnings of his minor child, he terminates a merely personal right belonging to himself. Hence, his creditors are unable to interfere so far as the child's future earnings are concerned. On the other hand, wages actually earned by the child before emancipation are property

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[10]But it seems that in a few states the grantor is allowed to sue for the price if he frames his action in such a way that it will not be based on an avowed fraud.

[11]*First National Bank v. Glass* (1897), 79 Fed. Rep. 706 (C.C.A.), per Sanborn, J.

[12]*Winchester v. Reid* (1861), 8 Jones' Law (N. C.), 379.

of the parent, and may, therefore, be attached by the parent's creditors.

A creditor cannot compel his debtor to work for him. If a debtor may refuse to work, should he not also be able to make a present of his earning power? So it has seemed to many courts, and there are decisions which hold that creditors have no rights whatever in property of a third person which has been enhanced in value through the labor of the debtor. The particular situation which is most apt to aggrieve creditors is that in which a husband expends his skill and practically all of his time upon his wife's business without charge.[12] Even if the situation is concededly untainted by actual fraud which would exist if the husband were conducting business in the name of his wife as a mere cover, still the fact remains that by accumulating property for his wife the husband accumulates a fund which in practice is often permanently available for his own support. It is, therefore, debatable whether a husband should be permitted in this way to withdraw from his creditors any results of his labor and skill that exceed reasonable allowance for the support of his family. Unfortunately there is little legislation on the question and the authorities are in considerable confusion. In a number of states there are decisions, generally in cases where the facts were extreme, permitting creditors of the husband to get so much of the wife's property as would represent the product of the husband's labor. Of course there is no doubt as to the rights of the husband's creditors whenever an insolvent husband expends his funds in making improvements on the property of his wife.

May a debtor (in the absence of a prohibitory statute) pay a favored creditor in full to the exclusion of others when he is insolvent? The answer has always caused surprise to many laymen. At common law, equality among the creditors is insisted upon only in a composition agreement. Since the grantee has a proper purpose of his own to serve, fraudulent intent on the part of the debtor even if known to the creditor who does not otherwise participate in the fraud, is immaterial. Preferences,

[12]For an interesting recent case of this sort see *Rowe v. Drohen, et ux*, (1919), 260 Fed. 15 (divided court).

however, are repugnant to the whole spirit of bankruptcy statutes, and the National Bankruptcy Act provides that preferences effected while the debtor is insolvent are a ground for putting him into involuntary bankruptcy at any time within four months thereafter if his condition of insolvency continues.

Similarly, a transfer of property is not fraudulent as to creditors when the debtor, although protected by some statutory provision giving a personal privilege, is under a moral obligation to the transferee. The payment of a debt is not a fraudulent conveyance even though the obligation be unenforceable because of the Statute of Limitations or the Statute of Frauds.

CHAPTER X

CONTRACTUAL MODES OF SAFEGUARDING AND FACILITATING CREDIT OPERATIONS

A. In General.

§270. *From Nathan Isaacs. The Teaching of Law in Collegiate Schools of Business.* 28 *Journal of Pol. Econ.* 121.

[The prospective debtor can offer numerous specially devised safeguards for the satisfaction of the prospective creditor.] "In the first place, he will probably have to submit a financial statement, either directly to the prospective creditor, or indirectly through one of the established mercantile agencies. This practical business device for putting credit on a sound basis is gradually coming to be recognized by the law. Old rules are just beginning to be applied by courts in a way to give the same effect to such statements in court as is actually given to them in business, and new statutes are being multiplied with the same end in view. But the statement alone, we shall assume, does not enable him to pass the scrutiny of a meticulous credit department. Some further security is necessary. Mortgages, real and personal, pledges, guaranty, and suretyship, including the signatures of friends on the face and on the back of notes, flash into the would-be debtor's mind. Perhaps the creditor is already supplied with a reasonable amount of credit-indemnity insurance. Perhaps the business is such that it is practicable to give effect to a lien, either on the basis of the express terms of the contract or such terms as may be supplied from custom or statute. But let us suppose all of these methods exhausted or for some reason inapplicable; what is left? Despair reveals a wonderful supply of hidden resources. The credit-seeker begins to think of his intangible assets and expectancies. Why not assign claims as securities, or amounts expected to accrue from existing con-

tracts? At this point let him stop to consider the ordinary difficulties in the collection of debts, that naturally make creditors hesitate about taking risks. Can he not remove some of them in advance? As a despairing borrower he is willing to waive as many of these as the law will permit. The formalities of summons and the right to appeal go by the board. The borrower is, of course, willing to make the evidence against himself as clear as possible by giving a note, and to make assurance doubly sure he will sign an authority to enter judgment against himself on the note. He will make the note payable at his own bank, thus giving it the effect of a post-dated check. And why not give a post-dated check, for in some lines of business this has become a well-recognized and effective instrument. But, to continue our waivers, the borrower may be willing to give up exemptions and any other debtor's rights that his state may interpose. Still, let us suppose, either because the law steps in to check these waivers, or because of the extrajudicial doctrine of *Shylock v. Antonio* it does not seem wise to extend credit on such a basis, what remains? At this stage students, and I suppose, credit seekers, make a great point of strong personal assurances, gentlemen's agreements, and points of honor. Of course, the purely personal relation and extra-legal sanctions play a very great part, a greater part than lawyers suppose, in the framework of our credit system. But business is business. At any rate, the credit-seeker has not begun to exhaust the possibilities of credit safeguards under the law.

His credit is pledged to the limit and he needs more goods. Suddenly he sees a light, and begins to think of certain substitutes for credit, and suggests what is frequently suggested in such cases, though not exactly on the basis of any law made and provided for them. He may take goods on consignment. Or he may become the creditor's *del credere* agent—perhaps that hard-hearted and hard-headed gentleman will be satisfied with the triple chance of getting his money out of the retailer, or out of the customer, or out of the goods. Perhaps something more than an interest in the particular goods may be required by the creditor. He may want a hand in the control of the debtor's

business. One may go the whole length of transferring the business to his creditor and become nominally the manager with certain privileges of buying the business back. Perhaps in such a case the debtor pays the cost of a surety company's bond for the further protection of the creditor. Or the creditor may simply be given a power of control in the business by being constituted a stockholder and director in a corporation running the business. The list of methods might be increased almost endlessly. Where borrower and lender are desirous of creating a safeguard, it is not difficult to invent one. I have even known of a case where a borrower agreed to employ his creditor as his bookkeeper, so that the latter could see that the borrower's affairs were all properly managed and his money safe.

To the lawyer, all of these subjects are simply unrelated, though time and a beneficent ignorance of our courts are gradually rubbing away some of the theoretic differences between two ways of doing the same thing. To the business student it is not enough, however, that he will recur to credit instruments in a hundred places if he studies mortgages, bills and notes, guaranty and suretyship, corporations and partnership, liens and pledges, assignments, agency, sales, and a little of every other head in the digest. To understand credit he must study the actual credit instruments in use in business, as so much law in action, and must be directed to such parts of our law in books as is necessary to explain them."[1]

B. Guaranty and Suretyship.

§271 *CAMPBELL v. SHERMAN.*

Supreme Court of Pennsylvania, 1892. [151 *Pa. St.* 70.]

McCOLLUM, J.: On the first of January, 1887, J. A. Homet, the appellant, bought of Adam Sherman two judgments against A. R. Robbins, on which there was then an unpaid balance of $592.38, and they were duly assigned to him. At the same time he loaned to Sherman $266.62. To secure the payment of the judgments and the money loaned he received the bond of Sher-

[1]Only the standard devices in common use are separately considered in the following pages: Suretyship, Guaranty, Pledges, Mortgages and the various contracts connected with Negotiable Instruments.

man in the sum of $859, on which, by virtue of the warrant of attorney contained therein, judgment was entered Jan. 3, 1887. On a distribution of the proceeds of a sale by the sheriff on the 13th of September, 1890, of the real estate of Sherman, the appellant claimed to apply on his judgment the fund remaining after paying costs and prior liens. The subsequent lien creditors of Sherman admitted that the appellant was entitled to receive the sum loaned, with interest thereon, but contended that Sherman was released from liability as to the balance because of the appellant's failure to revive the Robbins judgments. To this the appellant answered that his omission to revive these judgments did not release Sherman, and that, if it did, the creditors could not take advantage of it on distribution. The conclusion reached by the learned auditor was that he could not, at the instance of the lien creditors, set aside or disregard the judgment on the showing before him, but that Sherman might, in an appropriate proceeding, rely on the appellant's negligence as a defense to it. The learned president of the common pleas thought that this defense could be successfully made before the auditor by the lien creditors, and the fund was accordingly awarded to them.

In reviewing the decision of the court below, the first important inquiry is whether the obligation of Sherman in respect to the Robbins judgments was that of a surety or of a guarantor. If he was a surety, he was not released from liability by the negligence of the appellant, and the contention concerning the powers of the auditor has nothing to rest upon. It is well settled that mere forbearance, however prejudicial to a surety, will not discharge him, and that the failure of a creditor to revive a judgment does not release the surety, unless there was an express agreement that it should be kept revived for his benefit. *Winton v. Little,* 94 Pa. St. 64; *U. S. v. Simpson,* 3 Pen. & W. 437.

We think the undertaking of Sherman was that of a surety. His bond included the money loaned and the balance due on the Robbins judgments, and by its express terms was to remain in force until the whole sum was paid. The written conditions in the bond define the liability of the obligor, and we cannot add to them by implication a condition which would render them nugatory. The written condition applicable to this contention is that, if the judgment "shall be paid in full by the said A. R. Robbins, his heirs and assigns, to the said J. A. Homet, then this obligation to be void, otherwise to be and remain in full force and virtue."

The appellant purchased the judgments on the agreement of his vendor to pay them if Robbins did not. It was a contract

of suretyship, and not of technical guaranty, on which he parted with his money. On the failure of Robbins to pay the judgments at maturity, he was at liberty to proceed directly against the surety. He was not bound to resort to legal proceedings against Robbins or to show that they would have been unavailing in order to sustain process upon the bond. He was under no legal duty to the surety to revive the judgments, unless requested to do so, and, as no such request was made, negligence in this particular cannot be imputed to him. The law on this subject is stated by Agnew, J., in *Reigart v. White,* 52 Pa. St. 440, as follows:

> "A contract of suretyship is a direct liability to the creditor for the act to be performed by the debtor, and a guaranty is a liability only for his ability to perform this act. In the former the surety assumes to perform the contract of the principal debtor if he should not, and in the latter the guarantor undertakes that his principal can perform—that he is able to do so. From the nature of the former, the undertaking is immediate and direct that the act shall be done which if not done makes the surety responsible at once; but from the nature of the latter, non-ability, in other words insolvency, must be shown."

In *Kramph's Ex's v. Hatz's Ex's,* Id. 525, Woodward, C. J., discussing the same subject said: "The contract of a guarantor is to be carefully distinguished from that of a surety, for whilst both are accessory contracts, and that of a surety in some sense conditional, as that of a guarantor is strictly so, yet mere delay to sue the principal debtor does not discharge a surety. The surety must demand proceedings, with notice that he will not continue bound unless they are instituted. *Cope v. Smith,* 8 Serg. & R. 110.

"By his contract he undertakes to pay if the debtor do not; the guarantor undertakes to pay if the debtor cannot. The one is an insurer of the debt; the other, an insurer of the solvency of the debtor. It results as a matter of course out of the latter contract that the creditor shall use diligence to make the debtor pay, and, failing this, he lets go the guarantor." The foregoing extracts from the opinions of eminent Pennsylvania jurists draw with remarkable clearness and precision the distinction between a contract of suretyship and a contract of guaranty, and accurately define the respective rights and obligations of a surety and a guarantor. There has been no departure by this court from the principles announced in them, and they sustain the contention of the appellant that his omission to

revive the Robbins judgment did not affect Sherman's liability on his bond. It follows that it was error to award the fund to the subsequent lien creditors.

Decree reversed, and record remitted to the court below, with direction to distribute the fund in accordance with this opinion; the costs of this appeal to be paid by the appellees.

§272. *Guaranty and Suretyship.*—The words "guaranty" and "suretyship" are not always used with precision, and even when scientific definitions are attempted, they do not always agree. Disregarding technicalities, the following types of promise are all possible and must be carefully distinguished:

1. I will pay if he cannot (or if you cannot collect from him). 2. I will pay if he does not. 3. I will pay, though he got the benefit of the transaction and is also liable. 4. I will pay, though he got the benefit of the transaction and is not liable.

The first is a guaranty of solvency, or of the collectibility of the debt, and involves no liability on the part of the guarantor until the remedies against the principal debtor have been exhausted.

The second is a guaranty of payment. It involves no liability on the guarantor until breach, but it does not require the exhausting of legal remedies against the principal debtor. Both of these stipulations are agreements to "answer for the debt, default or miscarriage of another" and must, under the Statute of Frauds, be in writing in order to be enforceable. (*Cf.* §122, ff. *supra.*)

The third differs from the second in that there is an immediate liability assumed by the surety. So far as the creditor is concerned, the surety is primarily liable, along with the principal debtor. It is true, of course, that the debt cannot be collected twice and that, therefore, the agreement of the surety is practically, "I will pay unless he does." This is a little different from the stipulation, "I will pay if he does not." The former involves a condition subsequent which will release the surety; the latter, a condition precedent to the fixing of his liability. The distinction can easily be seen if he imagines a debt due at a specified time. The question is whether the debt is as-

sumed by both parties from the moment it is incurred, or whether it is to become a debt of the second party only after it falls due and remains unpaid. In this case (we may call it suretyship), the question whether the debt is that of "another" and therefore within the Statute of Frauds, is a question of fact, depending upon all of the circumstances. It may well be the joint or joint-and-several debt of the principal and surety incurred by both simultaneously, though no part of the consideration is received by the surety.[1]

The fourth case is neither suretyship nor guaranty; it is simply an independent obligation. There is nothing in the law of contracts to require that the consideration shall flow to the promisor or be a benefit to him. It is enough if a detriment is suffered by the promisee. It is, therefore, quite immaterial that a party other than the promisor takes all the benefit. It is as if A, wishing to make a present to B, bought an article on credit and ordered it delivered directly to B. B owes nothing.

It is well to remember, in analysing any case to see in which of these classes it belongs, that the cardinal principal is to ascertain the intention of the parties, and that all of the technical rules are mere crutches to help us if we find it difficult otherwise to reach this goal.

§273 *HARTLEY v. SANDFORD.*

Court of Errors and Appeals of New Jersey, 1901.
[66 *N. J. L.* 627.]

DIXON, J., delivered the opinion of the court:

The material facts in this case, as disclosed by the record, are that the defendant's son was indebted to M., who desired additional security; that thereupon the defendant applied to the plaintiff to become surety for the son, and promised him that, if he was compelled to pay the debt, he (the defendant) would reimburse him; that accordingly the plaintiff became surety for the son, and subsequently was obliged to pay the debt. This suit was brought upon the promise, which was oral only. It appears that at the trial in the Passaic circuit the jury were

[1] Williston, *Law of Contracts*, Vol. I, §466. As to the condition in negotiable paper, where the "status" of various signers is said to be fixed by law, *cf.* §§329, 332, 333, *infra.*

instructed to find for the plaintiff if they were satisfied the promise had been made; but the question as to the legal sufficiency of the promise was reserved and certified to the supreme court, which afterwards advised the circuit that the promise was valid, and thereupon judgment was entered on the verdict.

In this court error has been assigned on the charge at the circuit, as well as on the advisory opinion of the supreme court; but, there being no bill of exceptions presenting the charge, the assignment of error respecting it is futile, and must be disregarded. The assignment upon the opinion of the supreme court is legal, and presents the only question now before us, which is whether the plaintiff's suit can be maintained, in view of our statute, "that no action shall be brought to charge the defendant upon any special promise to answer for the debt, default, or miscarriage of another person, unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the person to be charged therewith or some other person thereunto by him or her lawfully authorized." The advice of the supreme court was based upon its opinion that under the adjudications in this state the promise of one person to indemnify another for becoming surety of a third is not within the statute. The cases cited in that opinion to support this view are *Apgar v. Hiler,* 24 N. J. L. 812; *Cortelyou v. Hoagland,* 40 N. J. Eq. 1; and *Warren v. Abbett* (N. J. L.) 46 Atl. 575. Of these, the only one of controlling authority here is that of *Apgar v. Hiler,* which is a decision of this court. That decision does not sustain the broad proposition for which it was cited. This court there held merely that, between two persons who had signed the same promissory note as sureties for another signer, the oral promise of one surety to indemnify the other was valid. This promise was deemed outside of the statute, because by signing the note the promisor had himself become a debtor, and so his promise to indemnify was to answer for his own debt. In *Cortelyou v. Hoagland* several stockholders and directors of a corporation had promised to indemnify another stockholder and director for indorsing a corporate note, and *Warren v. Abbett* was of similar character. In the Cortelyou Case the chancellor rested his decision on *Apgar v. Hiler,* which, as above stated, was essentially different, and on *Thompson v. Coleman,* 4 N. J. L. 216, which was a promise to indemnify a constable for selling under execution goods claimed by an outside party,—a case where the promisee had no redress except on the promise, and therefore clearly outside of the statute. If the decisions in *Cortelyou v. Hoagland* and *Warren v. Abbett* are to be supported on prior New Jersey adjudications, such

support must be found in the doctrine that where the consideration of a promise to answer for the debt, default, or miscarriage of another is a substantial benefit moving to the promisor, then the statute does not apply. This rule was recognized in *Kutzmeyer v. Ennis,* 27 N. J. L. 371, and *Cowenhoven v. Howell,* 36 N. J. L. 323. To support those decisions on this rule, it must be held that the payment of a corporate debt is substantially beneficial to the stockholders or directors of the corporation—a proposition which seems to be denied in other tribunals. Browne, *Stat. Fr.* §164. In the promise now under consideration there was no such element, and no case has been found in our reports involving the present question. We should therefore decide the matter on principle, or as nearly so as related adjudication will permit. Looked at as *res nova,* it seems indisputable that the defendant's promise was within the statute. It was to respond to the plaintiff in case the defendant's son should make default in the obligation which he would come under to the plaintiff as soon as the plaintiff became surety for him, an obligation either to pay the debt for which the plaintiff was to be surety, or to reimburse the plaintiff if he paid it. In this statement of the nature of the promise there is, I think, every element which seems necessary to bring a case within the purview of the statute. The parties, in giving and accepting the promise, contemplated (1) an obligation by a third person to the promisee; (2) that this obligation should be the foundation of the promise, *i.e.,* that the obligation of the son to the promisee should attach simultaneously with the suretyship of the plaintiff, and thereupon should arise the obligation of the promisor for the fulfillment of the son's obligation; and (3) that the obligation of the promisor should be collateral to that of the son, *i.e.,* if the latter should perform his obligation, the promisor would be discharged, while, if the promisor was required to perform his obligation, that of the son would not be discharged, but only shifted from the promisee to the promisor. An examination of the cases will show that not many of them are in conflict with this view, when they are free from differentiating circumstances. In the leading case of *Thomas v. Cook,* 8 Barn. & C. 728, such a circumstance appears in the fact that the promisor was himself a signer of the bond against which he promised to indemnify the promisee, and thus the promise was, in a reasonable sense, to answer for that which, as to the promisee, was the promisor's own debt. On this difference may be explained the decisions in *Jones v. Letcher,* 13 B. Mon. 363; *Horn v. Bray,* 51 Ind. 555, 19 Am. Rep. 742; *Barry v. Ransom,* 12 N. Y. 462;

Sanders v. Gillespie, 59 N. Y. 250; *Ferrel v. Maxwell,* 28 Ohio St. 383, 22 Am. Rep. 393; and others—resting on the rule applied in *Apgar v. Hiler,* 24 N. J. L. 812. The remark of BAYLEY, J., in *Thomas v. Cook,* that a promise to indemnify was not within either the words or the policy of the statute, has caused much of the confusion existing on this subject, but it is more than counterbalanced by the observations of Lord DENMAN in *Green v. Cresswell,* 10 Ad. & El. 453, and POLLOCK, C. B., in *Cripps v. Hartnoll,* 4 Best & S. 414, to the effect that a promise to indemnify may be also an undertaking to answer for the debt or default of another, and that when it is it comes within the operation of the statute. Another circumstance taking cases out of the simple class with which we are concerned is that mentioned in *Kutzmeyer v. Ennis,* 27 N. J. L. 371, 376, viz., the existence of a new consideration beneficial to the promisor, or, as it is sometimes expressed, moving to the promisor. Such cases are *Smith v. Sayward,* 5 Me. 504; *Lucas v. Chamberlain,* 8 B. Mon. 276; *Mills v. Brown,* 11 Iowa 314; *Reed v. Holcomb,* 31 Conn. 360; *Smith v. Delaney,* 64 Conn. 264, 29 Atl. 496; *Potter v. Brown,* 35 Mich. 274; *Comstock v. Norton,* 36 Mich. 277; *Harrison v. Sawtel,* 10 Johns. 242, 6 Am. Dec. 337; *Sanders v. Gillespie,* 59 N. Y. 250, *Tighe v. Morrison,* 116 N. Y. 263, 5 L. R. A. 617, 22 N. E. 164. Cases of still another character are sometimes cited in support of the statement that contracts to indemnify are outside of the statute, such as: *Cripps v. Harnoll,* 4 Best & S. 414; *Reader v. Kingham,* 13 C. B. N. S. 344; *Anderson v. Spence,* 72 Ind. 315, 37 Am. Rep. 162; *Keesling v. Frazier,* 119 Ind. 185, 21 N. E. 552; *Beaman v. Russell,* 20 Vt. 205, 49 Am. Dec. 775. But these judgments rest on the same idea as *Thompson v. Coleman,* 4 N. J. L. 216—that there existed no other liability to the promisee than that of the promisor, and so manifestly the statute was not applicable. On the other hand, there is sufficient judicial authority for the proposition that an undertaking to indemnify a person for becoming surety for another is, in the absence of any modifying fact, a promise within the statute. *Green v. Cresswell,* 10 Ad. & El. 453; *Simpson v. Nance,* 1 Speers L. 4; *Brown v. Adams,* 1 Stew. (N. J.) 51, 18 Am. Dec. 36; *Kelsey v. Hibbs,* 13 Ohio St. 340; *Clement's Appeal,* 52 Conn. 464; *Bissig v. Britton,* 59 Mo. 204, 21 Am. Rep. 379; *Nugent v. Wolfe,* 111 Pa. 471, 56 Am. Rep. 291, 4 Atl. 15; *Draugham v. Bunting,* 31 N. C. (9 Ired. L.) 10; *Hurt v. Ford,* 142 Mo. 283, 41 L. R. A. 823; 44 S. W. 228; and *May v. Williams,* 61 Miss. 126, 48 Am. Rep. 80—were decided on this basis. In the case last mentioned, PORTER, J., stated the true rules very clearly and concisely. No doubt, there are opposing

cases which cannot be explained on any distinguishing circumstances. Such seem to be *Chapin v. Merrill,* 4 Wend. 657; *Jones v. Bacon,* 145 N. Y. 446, 40 N. E. 216; *Dunn v. West,* 5 B. Mon. 376; *Vogel v. Melms,* 31 Wis. 306, 11 Am. Rep. 608; and *Wildes v. Dudlow,* L. R. 19 Eq. 198. But some of these cases merely follow *Thomas v. Cook,* 8 Barn. & C. 728, without noticing the distinction which later discussion has justified, while others appear to have been induced by the injustice of a refusal to enforce a promise on the strength of which the promisee incurred his liability, rather than by a ready purpose to execute the will of the legislature.

No doubt, injustice may result from the enforcement of the statutory rule; but that rule sprang from a conviction that its adoption would prevent more wrong than it would permit, and its enactment in England and perhaps every state in this Union indicates the generality of this assurance. Said Mr. Justice STERRETT in *Nugent v. Wolfe,* 111 Pa. 471, 56 Am. Rep. 291, 4 Atl. 15: "The object of the statute is protection against 'fraudulent practices commonly endeavored to be upheld by perjury,' and it should be enforced according to its true intent and meaning, notwithstanding cases of great hardship may result therefrom." With more detail did Chief Justice SHAW, in *Nelson v. Boynton,* 3 Met. 396, 37 Am. Dec. 148, say: "The object of the statute, manifestly, was to secure the highest and most satisfactory species of evidence in a case where a party, without apparent benefit to himself, enters into stipulations of suretyship, and where there would be great temptation on the part of a creditor, in danger of losing his debt by the insolvency of his debtor, to support a suit against the friends or relatives of a debtor—a father, son or brother—by means of false evidence, by exaggerating words of recommendation, encouragement to forebearance, and requests for indulgence into positive contracts."

Our conclusion is that the promise proved at the trial was insufficient to sustain the action, that the judgment for the plaintiff should be reversed, and that, in accordance with the reservation at the trial, a verdict and judgment should be entered in favor of the defendant.

§274. *The Fourth Section of the Statute of Frauds.*—A variety of tests have been applied by the courts in determining what promises to satisfy the obligations of another are within the 4th section of the Statute of Frauds. The promise to indemnify one who becomes surety for the debt of a third per-

son in reliance on the promise of indemnity is one of the many situations in which courts disagree as to the applicability of the Statute of Frauds. The case of *Hartley v. Sandford* represents the minority view. *Cf. Tighe v. Morrison* (1889), 116 N. Y. 263; *Guild v. Conrad* [1894], 2 Q. B. 885.

Among the tests that have been relied upon by courts to determine what cases of guaranty, suretyship, indemnity, and similar undertakings fall within the terms of the Statute of Frauds, "to answer for the debt, default, or miscarriage of another," are the following:

(1) The "main purpose" test—Was the promisor's main purpose to advance his own pecuniary interests or to secure the payment of the debt of another? *Kirby v. Kirby* (1915), 248 Pa. 117.

(2) The "new and beneficial consideration" theory—that a new and beneficial consideration moving to the promisor takes the promise out of the operation of the statute. This test seems applicable only if the new consideration is approximately equivalent in value to risk assumed. Williston on *Contracts,* Vol. I. §473.

(3) The question whether the promise was a mere incident to some other legal transaction clearly outside the scope and purpose of the Statute of Frauds—*e. g.,*

> (a) An incident to the contract of employment, that the employee will make good defaults in the accounts of customers whom he brings to his employer. *Sutton & Co. v. Gray,* [1894], 1 Q. B. 285.
>
> (b) A stipulation in the employment of a *del credere* agent that in accordance with the custom of merchants he shall answer to his principal for the accounts of his customers. *Couturier v. Hastie* (1852), 8 Exch. 40, 55; *Bullowa v. Orgo* (1898), 57 N. J. Eq. 428.
>
> (c) The obligations of parties secondarily liable on negotiable instruments.

(4) The question whether the promisee is the creditor of the original debtor. If the promise is made to the debtor or to a third person, it is outside the scope of the Statute and enforceable. *Eastwood v. Kenyon* (1840), 11 A. & E., 438.

(5) The absence of novation. Novation is not within the Statute, since the new promisor becomes the only debtor, the old debtor being discharged. *Smith Bros. & Co. v. Miller* (1907), 152 Ala. 485.

§275 *GATES v. McKEE.*

Court of Appeals of New York, 1855. [13 *N. Y.* 232.]

By Court, DENIO, J.: If this were the first time that an instrument of this character had been before a court, and we were now called upon to construe it without the light of adjudged cases, the first inquiry would naturally be whether the limit of five hundred dollars related to the amount of purchases to be made by M. E. McKee or to the defendant's ultimate liability; and I think it clearly qualifies the responsibility of the defendant, and not the amount of M. E. McKee's future transaction with the plaintiff. It is as if he had said: "I will be responsible to the amount of five hundred dollars for what stock M. E. McKee has had or may want hereafter," etc. I also think that the words "what stock," in their relation to future purchases, have the force of whatever stock or whatever amount of stock he may want hereafter; and the word "stock" alone denotes the supply of materials for the business of the party spoken of. The word "hereafter" seems to be used in an indefinite sense. It is not at any particular time in the future, but as if it were written at any time hereafter. The words "may want" are significant as to the character of the future dealings in contemplation, and they mean the same thing as may need or require, or may have occasion for. M. E. McKee was a shoemaker, and the plaintiff was a leather manufacturer; and reading of the paper as relating to their respective occupations, and giving the language the interpretation which I have suggested, and leaving out what is said of past indebtedness as immaterial, the following paraphrase would appear to me to express its true meaning: "Sir, I will be responsible to the amount of five hundred dollars for whatever amount of materials in his line M. E. McKee may at any time hereafter require." This is not a refined or artificial interpretation, but is what the plaintiff, or any other person to whom such a paper might be addressed would naturally and in my opinion unavoidably, understand from it. If this is the meaning which the paper naturally conveys, it is the sense which the court is bound to apply to it.

The cases are not entirely harmonious as to the principles of construction which ought to govern in this class of cases, but the weight of authority is altogether in favor of construing

guaranties by rules at least as favorable to the creditor as those which courts apply to other written contracts, irrespective of the consideration that the guarantor is a surety. In *Mason v. Pritchard,* 12 East, 227, the court said the words were to be taken as strongly against the party giving the guaranty as the sense of them would admit. The same remark is found in the opinion of the Supreme Court of the United States in *Drummond v. Prestman,* 12 Wheat, 515, which was the case of a guaranty. In *Douglass v. Reynolds,* 7 Pet. 115, 122, Judge STORY said, speaking of guaranties: "As these instruments are of extensive use in the commercial world, upon the faith of which large credits and advances are made, care should be taken to hold the party bound to the full extent of what appears to be his engagement." In *Lawrence v. McCalmont,* 2 How. 426, the attention of the same learned judge was directed particularly to this question of construction. After remarking that a question had been made on the argument whether the letters of guaranty under consideration should receive a strict or a liberal construction, he said: "We have no difficulty whatsoever in saying that instruments of this sort ought to receive a liberal interpretation. By a liberal interpretation we do not mean that the words should be forced out of their natural meaning, but simply that the words should receive a fair and reasonable interpretation, so as to attain the objects for which the instrument is designed, and the purposes to which it is applied. We should never forget that letters of guaranty are commercial instruments, generally drawn up by merchants in brief language, sometimes inartificial, and often loose in their structure and aim; and to construe the words of such instruments with a nice and technical care would not only defeat the intention of the parties, but render them too unsafe a basis to rely on for extensive credits, so often sought in the present active business of commerce throughout the world." Further on he says: "If the language used be ambiguous and admits of two fair interpretations, and the guarantee has advanced his money upon the faith of the interpretation most favorable to his rights, that interpretation will prevail in his favor; for it does not lie in the mouth of the guarantor to say that he may, without peril, scatter ambiguous words, by which the other party is misled to his injury."

These extracts express so happily my notion of the rules of construction which ought to prevail in this class of cases, that I need only add that the same general principle will be found asserted with more or less distinctness in *Bell v. Bruen,* 1 How. 169, 186; *Haight v. Brooks,* 10 Ad. & El. 309; *Mayer v. Isaac,*

6 Mee. & W. 605; *Dobbin v. Bradley,* 17 Wend. 422; *Hargreave v. Smee,* 6 Bing. 244. In the last case TISDALE, C. J., said: "There is no reason for putting on a guaranty a construction different from what the court put on any other instrument. With regard to other instruments, the rule is, that if the party executing them leaves anything ambiguous in his expressions, such ambiguity must be taken most strongly against himself." And BRONSON, J., in the case referred to from 17 Wendell, remarks that commercial guaranties are in extensive use, and that he can perceive no reason why they should not receive the same liberal construction for advancing the end which the parties had in view as is given to other contracts. I am aware that judges have in some few instances spoken of the construction *strictissimi juris* as the one to be applied to all contracts where sureties are sought to be charged, and that Judge Story himself, in an earlier case than the one from which I have quoted, expressed the opinion that where it was doubtful whether a guaranty created a continuing obligation, the presumption should be against it: *Cremer v. Higginson,* 1 Mason, 366. There is a sense, undoubtedly, in which it may be said that these obligations are to be strictly construed; and it is this: that the security is not to be held beyond the very precise stipulations of his contract. He is not liable on an implied engagement where a party contracting for his own interest might be, and he has a right to insist upon the exact performance of any condition for which he has stipulated, whether others would consider it material or not. But where the question is as to the meaning of the written language in which he has contracted, there is no difference, and there ought not to be any, between the contract of a surety and that of any other party. I feel no difficulty, therefore, in reading the short instrument which we are called upon to construe in the sense which every person, when informed of the situation of the parties, and who had considered the nature of the business it was designed to facilitate, would naturally place upon it. If I am right in the meaning which I have attributed to the several expressions contained in it, it did not look to a single transaction, or to dealings between the parties to a particular amount, and its purposes were not fully accomplished when the person whose credit was intended to be aided had once contracted a debt to the plaintiff to the amount of five hundred dollars, and had paid that debt. It contemplated a continuous business and a standing credit to the amount mentioned. If I am right in this (and the question is merely one of construction), there is no case or dictum which I have met with which will exonerate the defendant.

The adjudications are very numerous, and although I have examined more than I can conveniently refer to, I will mention the following only, each of which contains principles which will uphold the conclusion which I have arrived at, that this contract is a continuing guaranty: *Fellows v. Prentiss,* 3 Denio, 518 (45 Am. Dec. 484), Hand, senator; *Clark v. Burdett,* 2 Hall 197; *Douglass v. Reynolds,* 7 Pet. 113; *Bent v. Hartshorn,* 1 Met. 24; *Barstow v. Bennett,* 3 Camp. 290; *Rapelye v. Bailey,* 5 Conn. 149 (13 Am. Dec. 49); *Mayer v. Isaac,* 6 Mee. & W. 605; *Mason v. Pritchard,* 12 East, 227; *Hargreave v. Smee,* 6 Bing. 244; *Allan v. Kenning,* 9 Id. 618; *Hitchcock v. Humfrey,* 5 Man. & Gr. 560; *Martin v. Wright,* 6 Ad. & El. N. S. 917. In several of these cases the intention to guarantee a continuous trading was much more distinctly expressed than in the present case; but in others, such as *Mason v. Pritchard, supra,* which has repeatedly received the sanction of the courts of this country, and has never been disapproved of in any court, and in *Martin v. Wright, supra,* which was decided quite recently, the same liberal, or I may rather say natural and reasonable, intendment was made which I have supposed ought to be applied to the instrument under consideration.

The objection that the consideration was not sufficiently expressed to satisfy the requirement of the revised statute of frauds is answered by the judgment of this court in *Union Bank v. Coster's Ex'rs,* 3 N. Y. 204 (53 Am. Dec. 280).

I am in favor of affirming the judgment of the Supreme Court.

HAND, J., delivered a concurring opinion.

Judgment affirmed.

§276. *Construction of Contracts of Guaranty.*—There is a great deal of discussion in the books as to whether a contract of guaranty should be given a strict or liberal construction. Some cases lean towards a construction in favor of the guarantor for the equitable reason that he presumably has reaped no benefit from the transaction. This theory would not, of course, be extended to a surety company which has been paid for incurring a risk. Other cases go to the opposite extreme of declaring that words should be strictly construed against the guarantor as the one who chooses them. A better principle is to ignore the doctrines of liberal and strict construction and to interpret a contract of guaranty or suretyship according to the general principles of interpretation of contracts which aim primarily at the ascertainment of the intention of the parties.

§277 *CLARK v. KELLOGG.*

Supreme Court of Michigan, 1893. [96 *Mich.* 171.]

MONTGOMERY, J.: The plaintiffs sued the defendant, counting upon a breach of an agreement given on the occasion, and in consideration of the purchase by the plaintiffs from the defendant of a stock of goods and a quantity of notes and accounts. That portion of the agreement material to be considered in determining the questions involved read as follows:

"The said party of the first part . . . does covenant and agree . . . that the annexed invoice is a true statement of the amount and value of stock, merchandise, and property, and also guarantee, represent, and warrant that there is in said stock goods to the value of $14,709.68; also that the amount of $29,702.54 net shall be realized, without charging for the personal services of the parties of the second part, nor other charges of second parties, except incurred in suits, by the parties of the second part, upon the accounts and notes herein conveyed. The parties of the second part shall use due diligence in their collection."

The declaration counted upon this agreement, and set out no subsequent modification or waiver of its terms. On the trial the plaintiffs sought to recover by showing that they had dealt with the accounts as men of ordinary business judgment would, and also sought to show that the defendant had, as to a large portion of the accounts, directed the plaintiffs as to what he would require as evidence of due diligence, and that the plaintiffs had complied with the demands of the defendant in this regard.

1. The circuit judge construed the original contract as amounting to a guaranty of collection, and held that no showing of diligence was sufficient which did not include proof that the accounts had each been put in judgment, and execution had been taken out, and returned unsatisfied. This ruling was unquestionably right, if the proper construction was placed on the contract. *Bosman v. Akeley,* 39 Mich. 711; *Schermerhorn v. Conner,* 41 Id. 374.

It is contended, however, that the contract in question should not be construed as a guaranty of collection of each individual account, requiring resort to legal process in the collection of each, but amounted to a warranty and representation that there should be realized $29,702.54 from the total of the accounts; and that the fact that the amount guaranteed to be realized was much less than the face of the accounts negatives the idea that resort should be had to suit upon each account. The infirmity of this construction is that it ignores the subsequent

language. "The parties of the second part shall use due diligence in their collection," or accords to this language a meaning at variance with the settled significance of the terms employed. What constitutes due diligence is settled by the cases of *Bosman v. Akeley* and *Schermerhorn v. Conner, supra.*

In the case of *Ralph v. Eldredge*, 58 Hun (N. Y.), 203, a similar question was presented. Plaintiff and defendant were co-partners. Defendant conveyed his interest to the plaintiff in the notes, accounts and demands owing to the firm. The defendant at the same time executed to the plaintiff a bond with the condition that defendant should pay to the plaintiff one-half of the amount of the notes, accounts, and claims of the late firm assigned by defendant to plaintiff that should prove to be uncollectible, if any such there should be. The court say:

"It seems to be settled in this state that a guaranty of collection is an undertaking to pay the sum of money guaranteed, provided the principal debtor is prosecuted to judgment and execution with due diligence, and the same cannot be collected of him. . . . The plaintiff urges that the bond does not guarantee the collection of these claims, but is only a contract to pay plaintiff one-half of the amount of those which should turn out bad. But the bond uses the word 'uncollectible' and the question must be, what is the legal meaning of that word? That word has a definite meaning as decided in the cases above cited; and that meaning should be here enforced."

The legal signification of the term "due diligence," as applied to a guaranteed note or account, is well understood, and the parties must be assumed to have contracted with reference to that meaning.

2. The court rightly held that the alleged subsequent waiver could not be shown under the pleadings in this cause. The contract itself having fixed upon the plaintiffs a specific duty, the averment in the declaration that the plaintiffs did use due diligence amounted, in effect, to an averment that they had pursued the course which the law imposes upon them in order to charge the guarantor. If they relied on any excuse for failing to use due diligence, this should have been counted upon in the declaration. *Aldrich v. Chubb*, 35 Mich. 359.

Judgment affirmed, with costs.

The other Justices concurred.

§278 *DAVIS SEWING MACHINE COMPANY v. RICHARDS.*

United States Supreme Court, 1885. [115 *U. S.* 524.]

In error to the Supreme Court of the District of Columbia.

GRAY, J.: This was an action, brought in the Supreme Court of the District of Columbia, upon a guaranty of the performance by one John W. Poler of a contract under seal, dated December 17, 1872, between him and the plaintiff corporation, by which it was agreed that all sales of sewing machines which the corporation should make to him should be upon certain terms and conditions, the principal of which were that Poler should use all reasonable efforts to introduce supply and sell the machines of the corporation, at not less than its regular retail prices, throughout the District of Columbia and the Counties of Prince George and Montgomery, in the State of Maryland, and should pay all indebtedness by account, note, indorsement or otherwise, which should arise from him to the corporation under the contract, and should not engage in the sale of sewing machines of any other manufacture; and that the corporation, during the continuance of the agency, should sell its machines to him at a certain discount, and receive payment therefor in a certain manner; and that either party might terminate the agency at pleasure.

The guaranty was upon the same paper with the above contract, and was as follows:

"For value received, we hereby guarantee to the Davis Sewing Machine Company, of Watertown, New York, the full performance of the foregoing contract on the part of John W. Poler, and the payment by said John W. Poler of all indebtedness, by account, note, endorsement of notes (including renewals and extensions) or otherwise, to the said Davis Sewing Machine Company, for property sold to said John W. Poler, under this contract to the amount of three thousand ($3,000) dollars.

"Dated Washington, D. C., this 17th day of December, 1872.

"A. ROTHWELL,
"A. C. RICHARDS."

Under the guaranty were these words: "I consider the above sureties entirely responsible. Washington, Dec. 19, 1872.

"J. T. STEVENS."

At the trial the above papers, signed by the parties, were given in evidence by the plaintiff, and there was proof of the following facts: On December 17, 1872, at Washington, the contract was executed by Poler, and the guaranty was signed by the defendants, and the contract and guaranty, after being so signed, were delivered by the defendants to Poler, and by Poler to Stevens, the plaintiff's attorney, and by Stevens afterwards forwarded, with his recommendation of the sureties, to the plaintiff at Watertown in the State of New York, and the contract

there executed by the plaintiff. The plaintiff afterwards delivered goods to Poler under the contract, and he did not pay for them. The defendants had no notice of the plaintiff's execution of the contract, or acceptance of the guaranty, and no notice or knowledge that the plaintiff had furnished any goods to Poler under the contract or upon the faith of the guaranty, until January, 1875, when payment therefor was demanded by the plaintiff of the defendants and refused. At the time of the signing of the guaranty, the plaintiff had furnished no goods to Poler, and the negotiations then pending between the plaintiff and Poler related to prospective transactions between them.

The court instructed the jury as follows: "It appearing, at the time the defendants signed the guaranty on the back of the contract between plaintiff and Poler, the plaintiff had not executed the contract or assented thereto, and that the contract and guaranty related to prospective dealings between the plaintiff and Poler, and that subsequently to the signing thereof by the defendants the attorney for the plaintiff approved the responsibility of the guarantors and sent the contract to Watertown, New York, to the plaintiff, which subsequently signed it, and no notice having been given by the plaintiff to the defendants of the acceptance of such contract and guaranty, and that it intended to furnish goods thereon and hold the defendants responsible, the plaintiff cannot recover, and the jury should find for the defendants."

A verdict was returned for the defendants, and judgment rendered thereon, which on exceptions by the plaintiff was affirmed at the general term and the plaintiff sued out this writ of error pending which one of the defendants died and his executor was summoned in.

The decision of this case depends upon the application of the rules of law stated in the opinion in the recent case of *Davis v. Wells*, 104 U. S. 159, in which the earlier decisions of this court upon the subject are reviewed.

Those rules may be summed up as follows: A contract of guaranty, like every other contract, can only be made by the mutual assent of the parties. If the guaranty is signed by the guarantor at the request of the other party, or if the latter's agreement to accept is contemporaneous with the guaranty or if the receipt from him of a valuable consideration, however small, is acknowledged in the guaranty, the mutual assent is proved, and the delivery of the guarantee to him or for his use complete the contract. But if the guaranty is signed by the guarantor without any previous request of the other party, and in his absence, for no consideration moving between them except fu-

ture advances to be made to the principal debtor, the guaranty is in legal effect an offer or proposal on the part of the guarantor, needing an acceptance by the other party to complete the contract.

The case at bar belongs to the latter class. There is no evidence of any request from the plaintiff corporation to the guarantors or of any consideration moving from it and received or acknowledged by them at the time of their signing the guaranty. The general words at the beginning of a guaranty, "value received," without stating from whom, are quite as consistent with a consideration received by the guarantor from the principal debtor only. The certificate of the sufficiency of the guarantors, written by the plaintiff's attorney under the guaranty, bears date two days later than the guaranty itself. The plaintiff's original contract with the principal debtor was not executed by the plaintiff until after that. The guarantors had no notice that their sufficiency had been approved, or that their guaranty had been accepted, or even that the original contract had been executed or assented to by the plaintiff, until long afterward when payment was demanded of them for goods supplied by the plaintiff to the principal debtor.

Judgment affirmed.

§279. *Notice of Acceptance of Running Offers of Guaranty.*—An important point in the interpretation of a guarantor's words while they are still in the offer stage has to do with the question of "notice of acceptance." Of course an offer of guaranty may call for a promise on the part of the creditor, in which case "notice" would be required. Usually, however, the offer of the guarantor requests merely the giving of credit and not an antecedent promise to give it. In such cases some states have the rule that the guarantor's promise is binding if and when credit is extended, and no notice is required. In most jurisdictions, however, notice is held to be necessary. The reasoning in *Davis Sewing Machine Co. v. Richards* in support of this view is less satisfactory than that in *Bishop v. Eaton.* (See §103, *supra.*)

§280 *MAMEROW v. NATIONAL LEAD CO.*

Supreme Court of Illinois, 1903. [206 *Ill.* 626.]

MR. JUSTICE RICKS delivered the opinion of the Court: . . . The contract must be construed by and from its own terms and provisions, as far as they furnish a guide, and in aid thereof the circumstances of the making of the contract may be

taken into consideration. By the express words of the contract the makers guarantee the "payment, upon demand, of all moneys, debts, obligations and demands, of whatever nature or character, now due or which may hereafter become due from the Berner-Mayer Company." The language is broad, and if given the interpretation it would usually import, must be held to cover not only the indebtedness existing at the time of the execution of the guaranty and which might then be due or might thereafter become due, but also such indebtedness as might in due course of trade, thereafter be created and become due. If a guaranty is clear in its terms it must be interpreted and construed according to the language used; "that is to say, the parties must be presumed to have meant that which their language clearly imports. It is not what one of the parties may have intended, but what is shown by the contract to have been the intention of both parties." *Peoria Savings, Loan and Trust Co. v. Elder,* 165 Ill. 55. . . .

. . . Nor were the guarantors without reasonable protection against the acts of the Berner-Mayer Company under the contract as it is construed by us. As to all the indebtedness created after the execution of the guaranty the undertaking was collateral and continuing, and could be revoked or withdrawn at any time thereafter upon notice to defendant in error, and the guarantors' liability would, in such case, only cover the sales made pursuant to it and before the notice. (14 Am. & Eng. Ency. of Law, 2d ed., 1160, and authorities cited.) . . .

. . . Plaintiff in error contends that he was entitled to timely notice of the default of the Berner-Mayer Company, and that as notice was not given for about a year and a half after the failure and assignment of said company, he is released. Plaintiff in error offered a holding that it was the duty of defendant in error to give him "notice of the default of the Berner-Mayer Company within a reasonable time," and also offered another holding to the effect that although plaintiff in error was a stockholder and director of the Berner-Mayer Company such fact would not relieve defendant in error from its duty to give timely notice of the default; and further asked the court to hold that the burden of proof was upon the defendant in error to show that it had given notice of default within a reasonable time. The court refused these holdings.

The general rule undoubtedly is, that where the guaranty, as here, is a collateral, continuing one, the guarantor is entitled to reasonable notice of the default of the principal debtor. (*Taussig v. Reid,* 145 Ill. 488.) The purpose of this notice is to enable the guarantor, if he elects to pay the guaranty and at

once proceed against the principal debtor, to re-imburse himself for the moneys thus paid. The right to this notice is not an absolute right, however, in the sense that the failure to give it will, in all cases and under all circumstances, release the guarantor, but it is a relative right, and the failure to give it can only be availed of when it is made to appear that the guarantor has suffered loss by such failure. (*Taussig v. Reid, supra.*) If at the time of the default of the principal debtor the latter is insolvent, so that the creditor cannot collect his debt or any part thereof, the failure to give notice of the default can work no injury to him, and therefore such failure would be no defense. There must not only be a want of notice within a reasonable time, but also some actual loss or damage thereby caused to the guarantor, and if such loss or damage does not go to the whole amount of the claim, but is only to a part, the guarantor is not wholly discharged, but only *pro tanto*. Before a guarantor can be discharged by the failure of the creditor to give notice, it is incumbent upon the guarantor to show that he is prejudiced by such failure. (*Rhett v. Poe*, 2 How. 457; 14 Am. & Eng. Ency. of Law, 2d ed., 1152.) Such being the rule, it would seem that the question of notice or want of notice is a matter of defense. The guarantee has made a case by showing a guaranty broad enough to cover the transaction, and a sale or sales in compliance with and in reliance upon the guaranty and the default of the principal, and if the guarantor seeks to relieve himself from the liability, and upon the ground that notice of the default was not given him within a reasonable time, the burden rests upon him to show the failure to give the notice, and the consequent injury by the loss of the whole or a part of the debt for which he stood as surety. *Furst & Bradley Manf. Co. v. Black*, 111 Ind. 308; *Rhett v. Poe, supra; Voltz v. Harris*, 40 Ill. 155; *Farmers' and Merchants' Bank v. Kercheval*, 2 Mich. 505.

In *Furst & Bradley Manf. Co. v. Black, supra*, the court say: "The failure to give notice, and the resulting damages, were, however, matter of defense." In the case at bar, evidence was offered by plaintiff in error for the purpose of showing failure to give notice of default and consequent injury. The evidence was objected to and the objection sustained.

The entire offer as made by plaintiff in error was, that he had no notice until December, 1898, that credit had been extended by defendant in error to the Berner-Mayer Company subsequent to the date of the guaranty sued on, and had no notice of the default of the Berner-Mayer Company until the same date; that the Berner-Mayer Company was in possession of a large amount of goods, and continued to do business in Chicago, New York

and Brooklyn until December 17, 1897, and was in possession of enough goods during all the time that intervened from the making of the guaranty until December 17, 1897—the date upon which it made an assignment—to have satisfied the claim of defendant in error.

A creditor is not required to give notice of default to a guarantor where the guarantor has notice from an independent source, or where it is his duty, under the law, to take notice or, in other words, where, in law, he is chargeable with notice. The law does not require a useless act. In the case at bar the guarantors, by their written guaranty, styled themselves as both directors and stockholders of the Berner-Mayer Company. . . . . . Plaintiff in error, by his written guaranty, declared himself both a stockholder and a director of the defaulting company. He knew, then, that it was in embarrassed circumstances and that it required the guaranty of the men composing its directorate to enable it to continue its business. It would seem, too, from the express language of the guaranty, that the recitals and undertakings of the guarantors in that instrument were the consideration upon which the defendant in error accepted the guaranty and continued the sales under it. The record showing, as we think it does, that the sales made after the guaranty were in the due course of business and within the terms of the guaranty with defendant in error, it is our duty to hold that plaintiff in error was bound to take notice, and will be presumed to have had notice, of the extent of the purchases made by the Berner-Mayer Company under the guaranty, and of its default in payment.

In this view of the case, the refusal of the court to admit the evidence offered, if error at all, was harmless.

§281. *From William H. Loyd, The Surety,* 66 *U. of P. L. Rev.* 40.—"The surety is a favored debtor. It is said that no rule is better settled.[1] 'Where any act has been done by the obligee that may injure the surety the court is very glad to lay hold of it in favor of the surety.'[2] 'There is no moral obligation on the security beyond or superseded to his legal obligation.'[3] But upon what principles of justice is the rule founded? Is it not the usual complex of tradition, psychology, and economics

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[1]*State v. Churchill,* 48 Ark. 426 (1886); *In re Sherry,* 25 Ch. D. 703 (1884); Brandt on *Suretyship* (3d Ed.), §106.

[2]*Law v. East India Co.,* 4 Ves. 824 (1799).

[3]*Winston v. Rives,* 4 S. & P. (Ala.), 269 (1833); *Ratcliffe v. Graves,* 1 Vern. 196 (1683); *Simpson v. Field,* 2 Chan. Ca. 22 (1679).

that makes most rules of law easier to state than to explain? Active sympathy may be expected for one who has gratuitously bound himself for the debt or default of another in disregard of the scriptural warning.[4] Antonio is not the only reckless hero that has found a court predisposed to assist him. So also, it may be politic to encourage co-operation in mercantile transactions by reducing to a minimum the risk of the accessory.[5] The doctrine, too, may have been inherited from an earlier state of society where the very harshness of the law of suretyship called for the strictest definition of its limits. All of these elements may and usually do enter in varying proportions into the modern attitude toward one of the oldest relations of law."

§282 *PURSIFULL v. PINEVILLE BANKING COMPANY.*

Court of Appeals of Kentucky, 1895. [97 *Ky.* 154.]

EASTIN, J.: This action was brought December 12, 1893, in the Bell Circuit Court, by appellee, as assignee of the Pineville Banking Company, against appellant and one Hurst, on a note executed by them December 23, 1889, and payable thirty days thereafter to the order of said banking company, and negotiable and payable at said bank. This note was discounted at and was held and owned by said bank at the time of its maturity, January 23, 1890.

Appellant filed an answer in the court below, in which he alleged, among other things, that he was merely a surety and that his co-defendant, Hurst, was the principal in said note, and that these facts, as well as the fact that he had received no part of the proceeds of said discount, were well known to the bank at the time. Said answer further alleges that, at the time said note matured, and prior thereto, and for some time thereafter, the principal therein was a depositor with, and had to his credit as a general deposit in said bank a large sum of money, much more than sufficient to pay said note, that the bank had a lien thereon for the payment of said note, but, without the knowledge or consent of appellant, released its said lien and permitted

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[4] "He that is surety for a stranger shall smart for it, and he that hateth suretyship is sure." Proverbs xi, 15.

[5] "Without these constant acts of mutual kindness and assistance, the course of commerce would be prodigiously impeded and disturbed." Per Kent, C. J., in *Ludlow v. Simond,* 2 Caines Ca. 1 (1805), at page 58.

Hurst, the principal in said note, to withdraw the whole of said deposit, leaving the note unpaid; that it did not, at the maturity of said note, or any other time, notify appellant that the note was unpaid and that he, knowing that Hurst had this large deposit in the bank at and after maturity of the note, supposed it had been paid until this suit was brought against him thereon nearly four years thereafter. The answer further alleges that Hurst has, in the meantime, become and is wholly insolvent, and that if he shall be compelled to pay said note by reason of the bank having released its lien on said deposit, he will now be entirely without remedy against his principal.

To this answer appellee filed a general demurrer, which was sustained by the court, and thereupon, at the same term of court, appellant offered to file and tendered an amended answer in which, after reiterating the statements of his original answer, he also charges that this note, being made negotiable and payable at the bank, was, in effect, an order from Hurst on said bank to appropriate and apply from his deposit therein a sufficient sum to pay the note at maturity; that the bank was thereby made his agent to pay the same, and that, by the negligence of said bank, this application was not made, and the note not paid. It further pleads and relies upon the failure of the bank to apply to the payment of the note other deposits made by Hurst after the maturity of the note and when his insolvency was known to the bank.

To the filing of this amended answer appellee objected and insisted on his demurrer to the answer as offered to be amended, and the court sustained the objection and refused to allow the amended answer to be filed. Appellant declined to plead further, the petition was taken for confessed, a judgment for the amount of the note and interest was entered against him, and from that judgment he prosecutes this appeal.

In view of this statement from the record, and of the action of the court below in sustaining the demurrer to the original answer and refusing to allow the amended answer to be filed, we think there is but one question to be considered by this court.

That question is: Whether or not, in this state, the surety on a negotiable note, made payable at, and discounted to and owned by a bank which holds, on general deposit for the principal in the note, at the maturity thereof, a sum more than sufficient to pay the same, is discharged from liability thereon, by reason of the failure of such bank to apply to the payment of the note a sufficient sum from this unappropriated deposit, and by reason of its permitting the entire deposit to be checked out, for other purposes, by the principal, who afterward becomes insolvent?

This question has never been settled by any adjudication of this court, and we are aware that the decisions of the courts of other states are not in entire harmony, and that there is some contrariety of opinion among the textwriters on the subject.

In considering the proposition, it is well for us to remember that this bank was the absolute owner of this note and not a mere collecting agent to look after the proper presentment of the note, and to demand payment in behalf of another. The bank was the creditor of Hurst, the principal in the note, to the amount thereof, and was his debtor in the amount of the deposit then standing to Hurst's credit in the bank.

As to the right of the bank, under the doctrine of setoff, to have applied to the payment of this note, from Hurst's unappropriated deposit, enough money to pay the same, by simply charging the note to his account, there seems to be no difference of opinion, and it is only as to the duty of the bank in this respect as between it and the surety on the note, that the authorities differ.

As to this, Mr. Morse, in his text-book, says: "If a note payable at a bank is sent there for collection, and the bank fails to apply an unappropriated deposit of the maker to its payment, the indorser is discharged. When a creditor has within his control the means of paying the debt out of property of the debtor properly applicable to the purpose, and does not use the opportunity, but gives up the property, the surety is discharged." 2 Morse on *Banks and Banking,* 3d ed., §562.

A similar doctrine is laid down in some of the decisions of the state courts, particularly in the cases from Pennsylvania, in one of which the learned judge, after referring to the well-recognized principles that the relation between the bank and its depositor is simply one of debtor and creditor, and that the bank has the right to apply an unappropriated general deposit to the payment of a matured note held by it against its depositor, which right it may waive unless the rights of third parties have intervened, propounds the following query which seems to us very aptly to illustrate the situation in this case, to wit: "If I am the holder of A's note indorsed by C and when the note matures I am indebted to A in an amount equal to or exceeding the note, can I have the note protested and hold C as indorser? It is true A's note is not technically paid, but the right to setoff exists, and surely C may show, in relief of his obligation as surety, that I am really the debtor instead of the creditor of A. If this is so between individuals, why is it not so between a bank and individuals?" *Commercial Nat. Bank v. Henninger,* 105 Pa. St. 502.

Counsel for appellee, however, in support of their contention,

that the conduct of the bank in this case, as set forth in the answer and admitted by the demurrer, did not operate as a discharge of the surety, rely mainly upon the cases of *National Mahaiwe Bank v. Peck,* 127 Mass. 302, 34 Am. Rep. 368, and *Second Nat. Bank v. Hill,* 76 Ind. 223, 40 Am. Rep. 239.

As to the former, the case from Massachusetts, it is sufficient to say that it is clearly distinguishable from this case. There the bank held two notes of B, one of which was executed by him in his official capacity, as treasurer of a town, and the other was executed by him individually. B kept only a personal account with the bank. The note executed by him in his official capacity was indorsed by P, who, a few days after the maturity of that note, presented to the bank the check of B on his individual account, and demanded that it be applied to the payment of the official note on which P was indorser. To this demand the bank answered that it had already applied B's deposit toward the payment of his individual note, which had also matured, though not until after the maturity of the official note. In the action which was brought against P by the bank to enforce the collection of this official note which he had indorsed, it was shown that neither this note nor its proceeds ever went into or constituted any part of B's personal account in the bank, and it was accordingly held that the bank, as against the surety on this official note, had the right to charge up B's personal note, which had also matured, against his personal account, as it had already done before this demand was made upon it to pay the official note out of this account. The distinction between that case and this is apparent.

The case of *Second Natl. Bank v. Hill,* 76 Ind. 223, 40 Am. Rep. 239, relied on by counsel for appellee, does fully support the position for which they contend.

But in that case it is also held, in conformity with the well-settled doctrine on the subject, that a bank has the right, under the state of facts admitted in this case, to apply the deposit to the payment of its demand, if it chooses to do so. It is furthermore held in that case that a creditor may not release a collateral security given by the principal debtor, or a lien which it may hold on his property, without discharging the surety, and these propositions are, we believe, recognized as fundamental in all the cases. If the security be in the nature of a lien by pledge of collateral, or by mortgage, or under an execution against the principle debtor's property, then, in any such case, it would be admitted that a release by the creditor of such security would discharge the surety, to the extent, at least, of the value of the security so surrendered.

Now, while it is true that the bank in this case had not,

strictly speaking, a lien upon any money or property belonging to Hurst, and while the surety could not, perhaps, by paying this debt to the bank, have become entitled to demand of it repayment out of Hurst's deposit, which is laid down by some of the authorities as the true test, yet it seems to us that this bank, by the voluntary surrender to the principal of money more than sufficient to pay this debt, and which it is conceded that it had a right to apply to that purpose, has been equally reckless of the interests of this surety as though it had surrendered a security on which it had a specific lien. As said by the text-writer, above quoted from, in criticising this case in 76 Indiana: "If the bank at the maturty of a note held by it holds funds that, by the scratch of a pen, it could apply upon the note, thus securing itself, it is difficult to see why neglecting so easy a means of security is not as improper as giving up collateral expressly designated for the purpose of securing the note." 2 Morse on *Banks and Banking,* 3d ed., §563.

The right on part of this bank to retain a sufficiency of Hurst's deposit gave it the absolute control of an ample security for the payment of this debt. A lien by pledge could give no higher right to the security than this bank had. It had the unquestioned right to actually appropriate and apply this money, which it owed to Hurst, to the payment of Hurst's debt to it. It matters not whether the right to the security has its origin in the doctrine of setoff or under a pledge as collateral. It is the extent of the right to the security, rather than the source from which that right springs, that should determine the question whether the creditor can voluntarily surrender the security without releasing the surety; and, having had in its hands a fund which it could, by the mere exercise of its option to do so, have used for the satisfaction of this debt, and which, we may assume, the dictates of ordinary diligence and of prudent banking would have prompted it to thus use, this bank has, in our judgment, been guilty of bad faith toward the surety, who, according to the facts as they are admitted here, knew of this large deposit to the credit of his principal, who received no notice of the non-payment of the note until nearly four years thereafter, and who assumed, as he had a right to do under these circumstances, that the note had been paid at maturity.

If the facts be as alleged in the answer and admitted by the demurrer, and as we are bound, therefore, to assume them to be, this bank has shown such an utter disregard of, and such absolute indifference to, the interests of the surety, as to entitle him to a release from the liability which would have been satisfied by the principal, if the bank had simply chosen to have it satisfied,

and had exercised the option in favor of, instead of against, the surety.

Wherefore, the judgment of the lower court sustaining the demurrer to the answer and rendering judgment against appellant is reversed, and the action is remanded for further proceedings consistent with this opinion.

§283. *Releasing of Surety. Note in* 26 *Harv. L. Rev.* 763.—"The maker of a note after its maturity had general deposits with the bank holding the note sufficient to cover the debt, but afterwards withdrew them. *Held,* the surety is not released. *National Bank of Commerce v. Gilvin,* 152 S. W. 652 (Tex., Ct. Civ. App.).

The bank had the undoubted right to apply the deposit to discharge the debt. *Bank v. Brewing Co.,* 50 Oh. St. 151; *Clark v. Northampton Bank,* 160 Mass. 26, 35 N. E. 108. Any release by the creditor of securities, though acquired subsequent to the debt, releases the surety to the value of the security. *Baker v. Briggs,* 8 Pick. (Mass.) 122; *Rogers v. School Trustees,* 46 Ill. 428. If this is solely because the surety loses his right of subrogation against the security, it has no application in the principal case where there is no security. *National Mahaiwe Bank v. Peck,* 127 Mass. 298. For the bank has no lien on the deposits. Thus it cannot hold the deposit if the note is not due. *Merchants' National Bank v. Robinson,* 97 Ky. 552; *Columbia National Bank v. German National Bank,* 56 Neb. 803, 77 N. W. 346. If there were a lien, though the deposits were insufficient to cover the debt, their payment would discharge the surety *pro tanto. Wharton v. Duncan,* 83 Pa. St. 40; *Cummings v. Little,* 45 Me. 183. But such is not the law. *People's Bank v. Legrand,* 103 Pa. St. 309; *Bacon's Administrators v. Bacon's Trustees,* 94 Va. 686, 27 S. E. 576. But the creditor's duty to the surety is more than mere refraining from interference with his right to subrogation. Thus he must register documents if necessary to protect the security. *State Bank v. Bartle,* 114 Mo. 276, 21 S. W. 816. He must notify the surety in certain cases. 1 Brandt, *Suretyship,* 3 ed., c. viii. He must accept a tender by the debtor. *Curiac v. Packard,* 29 Cal. 194; *Spurgeon v. Smitha,* 114 Ind. 453, 17 N. E. 105. But he owes no duty to

accept burdensome security. *Fuller v. Tomlinson Brothers,* 58 Ia. 111, 12 N. W. 127. Nor to prosecute his claim against the estate of a deceased debtor within the short period allowed. *Sibley v. McAllaster,* 8 N. H. 389; *Villars v. Palmer,* 67 Ill. 204. *Contra, Bridges v. Balke,* 106 Ind. 332, 6 N. E. 833. Nor to prevent a judgment lien from expiring. *Kindt's Appeal,* 102 Pa. St. 441. Nor to prove against the estate in bankruptcy or insolvency. *Clopton v. Spratt,* 52 Miss. 251; *Schott v. Youree,* 142 Ill. 233, 31 N. E. 591. See 20 Harv. L. Rev. 502. Nor to sue the debtor though requested by the surety. *Hickok v. Farmers' & Mechanics' Bank,* 35 Vt. 476; *Harris v. Newell,* 42 Wis. 687. *Contra, Pain v. Packard,* 13 Johns (N. Y.) 174. An affirmative duty, then, is imposed when slight action by the creditor will greatly benefit the surety. In the principal case, only a transfer in the bank's books is required, and it seems that the duty should be imposed. *Pursifull v. Pineville Banking Co.,* 97 *Ky.* 154, 30 S. W. 203; *Commercial National Bank v. Henninger,* 105 Pa. St. 496. The weight of authority, however, holds the opposite result necessary to preserve the fluidity of bank deposits by protecting the bank in paying any check covered by a deposit. *Davenport v. State Banking Co.,* 127 Mass. 298. *National Mahaiwe Bank v. Peck,* 126 Ga. 136, 54 S. E. 977. There seems no reason for distinguishing between deposits at and those after the debt's maturity, but this has been done in one state. *People's Bank v. Legrand, supra; Commercial National Bank v. Henninger,* 105 Pa. St. 496."

§284 *SMITH v. SHELDEN et al.*

Supreme Court of Michigan, 1876. [35 *Mich* 42.]

COOLEY, C. J.: The legal questions in this case arise upon the following facts:

Prior to June, 1867, Eldad Smith, Isaac Place, and Francis B. Owen were partners in trade under the firm name of Place, Smith & Owen, and as such became indebted to defendants in error in the sum of $969 on book account.

In the month mentioned the firm was dissolved by mutual consent. Place purchasing the assets of his co-partners and agreeing to pay off the partnership liabilities, including that to the defendants in error. On the second day of the following

month Place informed the defendants in error of this arrangement, and that he had taken the assets and assumed the liabilities of the firm, and they, without consent or knowledge of Smith and Owen, took from Place a note for the amount of the firm indebtedness to them, payable at one day with ten percentum interest. They did not agree to receive this note in payment of the partnership indebtedness, but they kept it and continued their dealings with Place, who made payments upon it. The payments, however, did not keep down the interest. Place, in 1872, became insolvent and made an assignment, and Smith was then called upon to make payment of the note. This was the first notice he had that he was looked to for payment. On his declining to make payment suit was brought on the original indebtedness and judgment recovered.

The position taken by the plaintiffs below was, that as they had never received payment of their bill for merchandise they were entitled to recover it of those who made the debt, the giving of the note which still remained unpaid being immaterial.

On behalf of Smith it was contended that, by the arrangement between Place and his co-partners, the latter, as between the three, became the principal debtor, and that from the time when the creditors were informed of this arrangement they were bound to regard Place as principal debtor and Smith and Owen as sureties, and that any dealing of the creditors with the principal to the injury of the sureties would have the effect to release them from liability. And it is further contended that the taking of the note from Place, and thereby giving him time, however short, was in law presumptively injurious.

Upon this state of facts the following questions have been argued in this court:

1. Was the note given by Place in the co-partnership name for the co-partnership indebtedness, but given after the dissolution, binding upon Smith and Owen?

2. If Smith and Owen were not bound by the note, were they entitled to the rights of sureties? And

3. Did the taking of the note given by Place discharge Smith and Owen from their former liability?

On the first point it is argued in support of the judgment that when a co-partnership is dissolved the partner who is entrusted with the settlement of the concern should be held to have implied authority to give notes in settlement. On the other hand it is insisted that in law he has no such authority, and that if he assumes, as was done in this case, to give a note in the partnership name, it will in law be his individual note only.

Whatever might be the case if the obligation which was given had been a mere acknowledgment of the amount due, in the form of a due bill or I. O. U., we are satisfied that there is no good reason for recognizing in the partner who is to adjust the business of the concern any implied authority to execute such a note as was given in this case. This note was something more than a mere acknowledgment of indebtedness, and it bore interest at a large rate. It was in every respect a new contract. The liability of the parties upon their indebtedness would be increased by it if valid, and their rights might be seriously compromised by the execution of paper payable at a considerable time in the future if the partner entrusted with the adjustment of their concerns were authorized to make new contracts. It was assumed in *F. & M. Bank v. Kercheval,* 2 Mich. 506-519, that the law was well settled that no such implied authority existed, and we are not aware that this has before been questioned in this state. See *Pennoyer v. David,* 8 Mich. 407. We think it much safer to require express authority when such obligations are contemplated, than to leave one party at liberty to execute at discretion new contracts of this nature, which may postpone for an indefinite period the settlement of their concerns, when a settlement is the very purpose for which he is to act at all.

For a determination of the question whether Smith and Owen were entitled to the rights of sureties, it seems only necessary to point out the relative position of the several parties as regards the partnership debt. Place, by arrangement, had agreed to pay this debt, and as between himself and Smith and Owen, he was legally bound to do so. But Smith and Owen were also liable to the creditors equally with Place, and the latter might look to all three together. Had they done so and made collections from Smith and Owen, these parties would have been entitled to demand indemnity from Place. This we believe to be a correct statement of the relative rights and obligations of all.

Now a surety, as we understand it, is a person who, being liable to pay a debt or perform an obligation, is entitled, if it is enforced against him, to be indemnified by some other person who ought himself to have made payment or performed before the surety was compelled to do so. It is immaterial in what form the relation of principal and surety is established, or whether the creditor is or is not contracted with in the the two capacities, as is often the case when notes are given or bonds taken; the relation is fixed by the arrangement and equities between the debtors or obligors, and may be known to the creditor, or wholly unknown. If it is unknown to him, his rights are in no manner affected by it; but if he knows that one

party is surety merely, it is only just to require of him that in any subsequent action he may take regarding the debt, he shall not lose sight of the surety's equities.

That Smith and Owen were sureties for Place, and the latter was principal debtor after the dissolution of the co-partnership, seems to us unquestionable. It was then the duty of Place to pay this debt and save them from being called upon for the amount. But if the creditors, having a right to proceed against them all, should take steps for that purpose, the duty of Place to indemnify, and the right of Smith and Owen to demand indemnity, were clear. Every element of suretyship is here present, as much as if, in contracting an original indebtedness, the contract itself had been made to show on its face that one of the obligors was surety merely. As already stated, it is immaterial how the fact is established, or whether the creditor is or is not a party to the arrangement which establishes it.

This view of the position of the parties indicates clearly the right of Smith and Owen to the ordinary rights and equities of sureties. The cases which have held that retiring partners thus situated are to be treated as sureties merely, have attempted no change in the law, but are entirely in harmony with older authorities which have only applied the like principle to different states of facts, where the relative position of the parties as regards the debt was precisely the same. We do not regard them as working any innovation whatever. The cases we particularly refer to are: *Oakley v. Pasheller,* 4 Cl. & Fin., 207; *Wilson v. Lloyd,* Law R., 16 Eq. Cas., 60; and *Millerd v. Thorn,* 56 N. Y. 402.

And it follows as a necessary result from what has been stated, that Smith and Owen were discharged by the arrangement made by the creditors with Place. They took his note on time, with knowledge that Place had become the principal debtor, and without the consent or knowledge of the sureties. They thereby endangered the security of the sureties, and as the event has proved, indulged Place until the security became of no value. True, they gave but very short time in the first instance; but, as remarked by the vice chancellor in *Wilson v. Lloyd,* L. R., 16 Eq. Cas. 60, 71, "the length of time makes no kind of difference." The time was the same in *Fellows v. Prentiss,* 3 Denio 512, where the surety was also held discharged. And see *Okie v. Spencer,* 2 Whart. 253. But that indulgence beyond the time fixed was contemplated when the note was given is manifest from the fact that it was made payable with interest. In a legal point of view this would be immaterial, but it has a bearing on the equities, and it shows that the creditors received or bar-

gained for a consideration for the very indulgence which was granted, and which ended in the insolvency of Place. When they thus bargain for an advantage which the sureties are not to share with them, it is neither right nor lawful for them to turn over to the sureties all the risks. This is the legal view of such a transaction, and in most cases it works substantial justice.

The judgment must be reversed, with costs, and a new trial ordered.

The other Justices concurred.

§285. *The Requirement of Good Faith on Part of Creditor.*—Suretyship, as this case suggests, is largely a matter between co-sureties. To the outside world, sureties are merely debtors. Nevertheless, where notice is given that one of the parties is a surety, good faith requires that the creditor be careful in his dealings with the principal debtor not to prejudice the position or increase the danger of the surety.

Should extension of time unaccompanied by actual damage discharge a corporate surety for profit? See *People v. Traves* (1915), 188 Mich. 415, holding the negative in the case of a surety company.

Should an extension of time by a creditor accompanied by an express reservation of his rights against the surety discharge the surety? It is well settled that the surety is not discharged in such a case. See *Exchange Building, etc., Co. v. Bayliss* (1895) 91 Va. 134.

§286. *Suretyship in Negotiable Instruments under the N. I. L. Note in* 28 *Harv. L. Rev.* 102.—"The defendant signed a joint note as surety for his co-maker. The payee knew of the suretyship relation, but made a binding contract with the principal maker, extending the time of payment, without the knowledge of the defendant, and now sues him. *Held,* that the plaintiff may recover. *Cowan v. Ramsey,* 1914. 15 Ariz. 533; 140 Pac. 501.

A surety co-maker will be discharged, at common law, by a binding extension of time given the principal debtor by a holder with notice of the suretyship relation. *Pooley v. Harradine,* 7

E. & B. 431; *Horne v. Bodwell,* 5 Gray (Mass.) 457. The principal case decides that the Uniform Negotiable Instruments Law abrogates this rule and permits recovery against the surety. Section 120 of the Act enumerates the different modes of discharging a party secondarily liable, including the case of extension of time to the principal debtor. But it is obvious that a surety co-maker, being 'by the terms of the instrument absolutely required to pay the same,' is primarily liable under section 192. Section 119 gives five ways of discharging the instrument without mentioning discharge by extension of time to the principal. It is argued, therefore, in the principal case that since the provision as to discharge by extension of time is included in the section dealing with the discharge of parties secondarily liable and omitted from the section as to the discharge of the instrument, and hence parties primarily liable, the legislative intent was not to discharge parties primarily liable in this manner. *Union Trust Co. v. McGinty,* 212 Mass. 205, 98 N. E. 679; *Cellers v. Meachem,* 49 Ore. 186, 89 Pac. 246. Such an inference would not seem necessary, however, since §119 deals not with the discharge of parties to the instrument, but with the discharge of the instrument itself, and the discharge of the surety co-maker would not be a discharge of the instrument. Hence the omission of the provision as to extension of time would have no significance. By §196, cases not provided for by the Negotiable Instruments Law are governed by the law merchant. The ordinary rules of suretyship would, therefore, apply to the principal case and the surety co-maker should be discharged by the extension of time. This result seems permissible by a fair construction of the statute, and would avoid overthrowing the established law of suretyship. *Farmers' Bank of Wickliffe v. Wickliffe,* 134 Ky. 627, 121 S. W. 498. See Brannan, *Negotiable Instruments Law,* p. 117. [At p. 314 in 3d ed.]"

§287 *ERFURTH v. STEVENSON.*

Supreme Court of Arkansas, 1903. [71 *Ark.* 199.]

BATTLE, J.: . . . Were John Schapp and S. A. Williams, sureties on the bond of Erfurth & Seibert for the per-

formance of their contract to erect a building for E. H. Stevenson, discharged by the alteration of the contract?

In *O'Neal v. Kelley*, 65 Ark. 550, this court held that any material alteration in the contract for the performance of which a surety is bound, without his consent, discharges the surety, and that "this is so, even if the alteration be for the benefit of the surety, for, although the principals may change their contract to suit their pleasure or convenience, they cannot thus bind the surety." . . .

. . . In the contract before us Stevenson, for whom the building was to be erected, was vested with the power to require alterations to be made in the construction of the building and in the arrangement or finish of the work, as specified in the contract and specifications, plans and drawings referred to therein. He could do so without the consent of the contractors, Erfurth & Seibert. But they were not compelled to do the additional work, or furnish the materials made necessary by the alterations. If they refused to do so, or failed to agree with Stevenson as to price, the contract provided that Stevenson might employ other parties to do such work and furnish the materials. But nevertheless, as said in *Miller-Jones Furniture Co. v. Fort Smith Ice & Cold Storage Co.,*[1] "the fact that these alterations . . . could be made without the consent of the contractors forces us to the conclusion that the alterations referred to were such minor changes as owners often wish to make in the plan of buildings while they are under construction, and which do not greatly affect the undertakings of the contractor." Any other construction of the contract would place the contractors in the position of agreeing that alterations might be made in their contract which would be materially injurious to them, which would be unnatural and unreasonable.

The right to make the alterations that were made in the contract depends upon the following clause: "The party of the first part (Stevenson), through his architect, may require alterations to be made in the construction, arrangement or finish of the work from that herein, and in said specifications, plans or drawings, expressed." The alterations made were not in the arrangement or finish of the work, as they consisted entirely of a change of materials. Were they made in the construction? In the construction of what? A two-story brick residence, with stone basement, and with roof covered with Oregon cedar shingles. Did Stevenson have the right to so alter the contract as to substitute a residence of granite for the brick residence? Certainly not.

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[1]66 Ark. 287; 50 S. W. 508.

Why then could he substitute a slate for a shingle roof? Such a change would not be in the construction of a shingle roof, which the contractors agreed to make, but a substitute for it, which was not authorized by the contract. The evidence shows that such was not the intention of the contract. Stevenson, the party of the first part, had under consideration, before entering into the contract with Erfurth & Seibert, the building of the residence with a slate roof, but abandoned it because it was too expensive, and decided to use Oregon cedar shingles instead of slate.

The price which the contractors, Erfurth & Seibert, were to receive for the building under their contract with Stevenson, before it was altered, was $2,670, and the alterations were worth and cost at least $320, which increased the cost more than eleven per cent. The change made in the building by the amended contract materially increased the cost of it beyond the original contract price, and, if binding on the sureties on the contractor's bond, increased their liability to the same extent. But the change was unauthorized by the original contract, and was made without the consent of the sureties, and discharged them from liability on their bond.

[Do you agree with the court's interpretation of the clause regarding alterations?—Edrs.]

C. Mortgages and Conditional Sales.

§288 *TRIMM v. MARSH.*

New York Court of Appeals, 1874. [54 *N. Y.* 599.]

This was an action for an accounting as to the amount due upon a bond and mortgage, and for the recovery of the possession of the mortgaged premises, upon payment of the amount due.

In 1858 one Ridgway, being the owner of certain premises situate in the City of New York, mortgaged them to an insurance company to secure $2,000; the insurance company assigned the mortgage to the defendant, Sarah A. Marsh. Ridgway afterward conveyed the premises to the plaintiff Brown, who subsequently, in October, 1865, entered into an agreement with plaintiff, Trimm, to convey the same to him. In 1861 the defendant, Sarah, commenced an action to foreclose this mortgage, making plaintiff Brown and others parties defendant, and obtained judgment of foreclosure. The premises were sold under the judgment in 1862, and defendant, Sarah A. Marsh, became the purchaser, and received a sheriff's deed. Immediately after

the sale she entered into possession of the premises, and she or the other defendant has ever since been in possession. In October, 1864, by an order of the Supreme Court, granted after due notice and hearing the parties interested, the foreclosure sale was set aside and declared null and void, and a re-sale was ordered, which never took place. In November, 1864, the defendant, Sarah A. Marsh, recovered a judgment against plaintiff Brown, which was duly entered and docketed, and in 1865 she caused an execution to be issued upon said judgment to the sheriff of New York, who, in May of the same year, sold all "the right, title and interest" of which the said Elizabeth C. Brown was seized or possessed in the said land, the said Sarah A. Marsh becoming the purchaser and taking the sheriff's certificate of sale. September, 1865, she conveyed the said premises by deed to the other defendant, and in September, 1866, after the commencement of this suit, she also transferred to him the sheriff's certificate, and he soon after received the sheriff's deed. The defendant, William B. Marsh, had notice of all the facts when he took his title, and was not a *bona fide* purchaser for value. Since the defendants went into possession of the premises they have assumed and claimed an absolute title, free from any right of redemption in the plaintiffs or either of them.

The plaintiffs commenced this action to redeem the said premises from the mortgage and judgment of foreclosure, and the principal defense relied on by the defendants was their title under the judgment and execution sale against plaintiff, Brown. The referee decided the same in favor of plaintiffs, holding that the execution sale, being made by the assignee of the mortgagee in possession, was null and void and conferred no title upon the purchaser.

EARL, C.: The only legal proposition involved in this case, which we deem it important to consider, is whether a mortgagee of real estate in possession can cause the equity of redemption of the mortgagor to be sold on an execution and become the purchaser of the same, and, after obtaining the sheriff's deed, set up his title thus acquired against the claim of the mortgagor to redeem from the mortgagee in an equitable action commenced by him for that purpose; or, to state the proposition in other words, has the owner of the equity of redemption of mortgaged premises, after default and after the owner of the mortgage has taken possession, such an interest in the premises as can be sold upon execution against him? If this question be answered in the affirmative, the decision of the General Term was right and must be affirmed. The respective rights of the mortgagor and mortgagee in the land mortgaged have been the subject of much

discussion, and it is impossible to reconcile all that learned judges and writers have said upon the subject. By the common law of England the legal estate was vested in the mortgagee, to be defeated by the performance of a condition subsequent, to wit, payment at the law day. In default of such payment, the title became absolute and irredeemable in the mortgagee. But, two centuries ago, courts of equity assumed jurisdiction to relieve mortgagors against forfeitures, and, thenceforth, in equity a mortgage has been regarded as a mere security, as creating an interest in the mortgaged premises of a personal nature, like that which the mortgagee has in the debt itself. . . .

The common-law rule, as modified by the equitable principles above alluded to, still prevails in England. There the courts still hold that the legal title passes to the mortgagee, and becomes by default absolutely vested in him at law, and that the mortgagor has, after default, nothing but an equity of redemption to be enforced in a court of equity. After default the mortgagor can again become reinvested with the title to his land only by a reconveyance by the mortgagee. The same rule prevails in the New England States, and many other states of the Union. But this common-law rule has never, to its full extent, been adopted in this state. Here the mortgagor has, both in law and equity, been regarded as the owner of the fee, and mortgage has been regarded as a mere chose in action, a mere security of a personal nature.

At common law, payment or tender at the law day extinguished the lien of the mortgage and reinvested the mortgagor, without a reconveyance by the mortgagee, with his title. But tender of payment after the law day did not have this effect, and in such case a reconveyance was necessary; and such is still the rule in England and in many of the states of the Union. But it has always been the law of this state that payment or tender, at any time after the mortgage debt became due and before foreclosure, destroyed the lien of the mortgage and restored the mortgagor to his full title. As the mortgagee had no title, a reconveyance was not required by the law as expounded by our courts. So that here the term law day, which occupies such a prominent place in the early discussions as to mortgages, has no particular significance. The mortgagor has his "law day" until his title has been foreclosed by sale under the mortgage, and it is a misnomer in this state to call the mortgagor's right in the land, before or after default, an equity of redemption, a mere right to go into equity and redeem. This was a proper description of the mortgagor's right in the land according to the law as expounded in England. But in this state the

interest of the mortgagor in the land is the same before and after default, and is a legal estate, with all the incidents and attributes of such an estate.

But it is claimed by the learned counsel for the appellants that the position of the mortgagee is materially changed when he gets possession. It is true, nothwithstanding the provision of the Revised Statutes, which prohibits an action of ejectment by the mortgagee to obtain the possession of the mortgaged premises, that after he has lawfully obtained the possession he may retain it until the debt secured by the mortgage has been paid. Before taking possession the mortgagee has no title in the lands. How can the mere possession change the title from the mortgagor to the mortgagee, or in any way diminish the estate of one or enlarge the estate of the other? Before taking possession the mortgagee had a mere lien upon the real estate pledged for the security of his debt. After possession he has in his possession the property pledged as his security, the title remaining as it was before. The mortgagor's title is still a legal one, with all the incidents of a legal title subject to the pledge, and the mortgagee's interest is still a mere debt secured by the pledge. If the mortgagee should die in possession, the debt would still go to his personal representatives to be administered as personal estate, and the mortgagor's title would go to his heirs. Payment, or even tender, would destroy the mortgagee's right to retain possession, and would enable the mortgagor to maintain ejectment to recover possession. The mortgagee, in such case, so far from having any title, holds the land as the land of the mortgagor, and is liable to account to him for the rents and profits. Judge Comstock, in *Kortright v. Cady,* 21 N. Y. 343, says: "The mortgagee's right to bring ejectment, or, being in possession, to defend himself against an ejectment by the mortgagor, is but a right to recover or retain possession of the pledge for the purpose of paying the debt. Such a right is but the incident of the debt, and has no relation to a title or estate in the land. The notion that a mortgagee's possession, whether before or after default, enlarges his estate, or in any respect changes the simple relation of debtor and creditor between him and his mortgagor, rests upon no foundation. We may call it a just and lawful possession, like the possession of any other pledge, but where its object is accomplished it is neither just nor lawful for an instant longer."

I cannot doubt, therefore, that the mortgagor, after default, and after the mortgagee has taken possession, has such an estate in the land as can be sold upon execution. It is not necessary to decide whether, in such a case, the mortgagee has also such an

estate in the land as can be sold upon execution, because, if he has, it does not follow that the mortgagor has not also such a right. They might each own an estate which could be sold. But I am of opinion that the mortgagee has no estate in the land which can be sold on execution. His interest is a mere chose in action, a debt secured by a pledge of real estate. His debt is not merged in the real estate by the possession. He has no interest in the real estate which he can sell, or which can be sold separate from the debt. Such a sale would convey nothing. Whoever took the real estate from him would take it subject to the same liability as he was under to account for the rents and profits to the mortgagor. It has been decided that a transfer of the mortgage without the debt is a mere nullity (*Merritt v. Bartholick*, 36 N. Y. 44). . . .

I am, therefore, of the opinion that the title of the defendant under the execution sale was valid, and that the plaintiff had no right to redeem.

The order of the General Term must be affirmed, and judgment absolute rendered against the plaintiffs, with costs.

§289. *Mortgages in Anglo-American Law.*—In dealing with real estate mortgages, it must be remembered that in Anglo-American law, a mortgage does not mean what it says on its face. A real estate mortgage reads as if it were a simple conveyance of property to the creditor, coupled with a defeasance clause, to the effect that the document shall be void if the debt for which it is given be paid. According to the older English doctrine, still in force in most of the eastern and southern states, the mortgage operates as a conveyance capable of being destroyed on the law day, that is, the time set for the payment of the debt. Of course the borrower still is given an opportunity in equity to redeem by paying his debt and interest; that is, he has what is known as an equity of redemption after the law day. For a long time, however, the defeasance clause has been interpreted in New York and most American states as a condition precedent, instead of a condition subsequent; that is, the mortgage does not operate as a conveyance until after the condition is broken. The more modern doctrine in force in most American jurisdictions thus abandons entirely the notion of a conveyance and regards the mortgage as the creation of a lien for the security of the creditor, leaving the legal title and

estate in the mortgagor. In Delaware, Mississippi, and Missouri, the lien theory of a mortgage controls its operation only until the law day, the mortgagee being entitled after the law day to take possession of the land and being thereafter treated substantially as if he were the legal owner.

Under the predominant American doctrine, a mortgage has become a kind of formal contract in which the form has degenerated into a sort of hocus-pocus or ceremony having very little correspondence with the actual terms of the agreement that have been formulated in courts of equity. Inasmuch as the terms of this agreement are not expressed, it is difficult for the parties to such a transaction to control them. The mortgage is, in other words, a highly standardized contract.

Can this effect be brought about by an actual contractual arrangement which disregards the old formalities of conveyance and defeasance clause? For taxation purposes it has been held that a lease with a privilege of purchase is, if actually intended to secure an unpaid balance on the purchase price, to all intents and purposes the same as a sale with a mortgage back. Compare, however, the next case.

§290 *BRITT v. HARRELL.*

Supreme Court of North Carolina, 1890. [105 *N. C.* 10.]

The plaintiffs allege, in substance, that in February, 1888, Dunn & Kitchen were engaged, in the county of Hertford, in getting railroad ties for market, and while so engaged the plaintiffs made advances to them in money and supplies to a large amount; that on the 13th day of February, 1888, "said Dunn & Kitchen were indebted to said Britt & Lawrence in the sum of $132.26, balance on said supplies," for which they executed their promissory note, in words and figures as follows:

"Winton, N. C., February 13, 1888.

"$132.26

"We promise to pay Lawrence & Britt, out of the proceeds of certain railroad ties we now have in Hertford County, amounting to about forty-two hundred, the sum of one hundred and thirty-two 26-100 dollars, with interest thereon from December 3d, 1887, to be paid as follows: First deducting eighteen hundred ties for O. H. Perry, from the first amount hauled, then we will pay

Lawrence & Britt, out of the remainder, at the rate of ten cents a piece for all delivered to transportation until they are paid in full, and authorize purchaser to retain said amount for them.

"Witness our hands, this the 13th day of February, 1888.

"Witness: Dunn & Kitchen.

"R. W. Winborne."

The said paper-writing was duly proved and registered in Hertford County on the 14th day of February, 1888, and "thereafter Dunn & Kitchen did not cut and hew any more ties in said county, and said 4,200 ties were all that they had in said county at that time;" that "about the 1st of April, 1888, Dunn & Kitchen delivered 800 ties for transportation, and left the remainder in the woods where they were cut; that about June 1st, 1888, Dunn & Kitchen abandoned the state, or kept themselves concealed therein to avoid service of summons, and with intent to defraud their creditors; and thereupon J. J. Jordan and S. J. Holloman, upon whose lands the ties were cut, sued out an attachment against them, and, under proceedings therein, the remainder of said ties, about 3,400, were sold at public sale, and the defendant, Harrell, became the purchaser; the ties so purchased were those owned by Dunn & Kitchen, in Hertford County, at the time of the execution by them of the said paper-writing, and embraced within its provisions; the defendants, J. P. Harrell and A. C. Vann, hauled to a point on the banks of the Chowan River, for transportation, 2,000 or more of the ties. No part of said note has ever been paid, and the plaintiffs allege that they have an equitable lien to have said ties subjected to the payment thereof. Dunn & Kitchen are totally insolvent, as is also Harrell, who is threatening to sell and remove said ties, and, if permitted to do so, the plaintiffs will sustain irreparable loss. Harrell purchased with full knowledge of the claim of plaintiffs, and they ask that he be restrained, etc."

DAVIS, J.: after stating the case: The sole question presented in this case is: Was the paper executed by Dunn & Kitchen a chattel mortgage? Was it sufficient to constitute a lien, legal or equitable, in favor of the plaintiffs against a purchaser at a sale made by the sheriff under execution?

Whether the instrument, in itself, is a mortgage, is a question of law to be determined by the Court. *Comron v. Standland*, 103 N. C. 207; Jones on *Chattel Mortgages*, 18.

In the case before us there is nothing in the paper to indicate that Lawrence & Britt shall "have a lien" upon the rail-

road ties. Nothing found therein imports a conveyance of the title to the ties. No authority is given to sell the property upon default of payment, or in any way to dispose of or control it. There is nothing to bring it within the definition of a legal mortgage. Jones on *Chattel Mortgages,* 1, *et seq.*

But it is insisted that it is an equitable assignment or appropriation of the ties to the payment of this debt, and the purchaser at the sheriff's sale had notice. We do not think it can be so considered. It was only a promise by Dunn & Kitchen to pay money, with the additional promise that they would pay it "out of the proceeds" of the ties.

While "no particular form is necessary to constitute a mortgage," yet the words must "clearly indicate the creation of a lien, specify the debt to secure which it is given and upon the satisfaction of which the lien is to be discharged, and the property upon which it is to take effect." "The statement that the creditor is to have a lien, and that on default he may take possession and sell, . . . sufficiently discloses the intent." *Harris v. Jones,* 83 N. C. 317, and cases cited. The instrument under review gives the plaintiffs, in no event, authority to take possession and sell the ties.

A debtor says to his creditor: "I will send cotton which I have in my gin to my commission merchant and pay your debt out of its proceeds, or I will authorize him to retain it for you." The debtor sends the cotton off and sells it, or it is seized under execution and sold by the sheriff. Would the creditor, in such a case, even though he had registered the promises of his debtor, have a right, in law or equity, to follow the property and have it applied to the payment of his debt? However, it might be as between the parties, one making the promises and the other relying on them, in the absence of any charge or circumstances of fraud or collusion to cheat the debtor, as to third persons, such an agreement could, in no sense, be regarded or treated as a mortgage of the cotton. . . .

The plaintiffs had nothing in addition to their note but the promises of Dunn & Kitchen that they would pay "out of the proceeds of certain railroad ties, etc.," and "authorize the purchaser to retain" the amount of their debts for them; and these promises, without a transfer of the title to the ties, as security, were worth no more, it seems, than the promise to pay the money.[1]

Affirmed.

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[1] In *Hunt v. Rousmanier's Adm'rs* (1823), 8 Wheat. 174, a power of attorney to sell a ship was given instead of a mortgage, but upon the death of the owner, it was held that the power of attorney had been terminated in spite of the intention of the parties.

§291. *Chattel Mortgages and Conditional Sales.*—This case states the prevailing American law that a mortgage of personal property is regarded something more than a mere security—it passes the legal title which becomes absolute in the mortgagee upon default. In this respect a mortgage of personal property is like a mortgage of real estate under the old common law. There is a chattel mortgage whenever the language of the parties indicates that title has been transferred to the mortgagee but that the transfer is to be void upon the fulfillment of some condition, for instance, the payment of a debt. If in fact there is a defeasance agreement the transaction is a mortgage between the parties even though the conveyance of goods was made in a writing absolute in form.

There can be no mortgage without a conveyance from a debtor to his creditor. There are, however, other security arrangements in which the person having "a security title" to goods has consented to give the possession and use of them to another. Such is the well-known "conditional sale." Strictly this is a mere contract to sell the goods, the contract providing that the property in the goods is not to vest in the buyer until the performance of a specified condition, generally the payment of the price.

In case the buyer under a conditional sale contract is in default in the payment of any part of the price, the seller may not only resume possession of the goods, but in many states the buyer forfeits the part payments previously made. In jurisdictions which still retain this old strict rule of forfeiture the arrangement entails a hardship on the delinquent buyer from which a mortgagor who is in default has long been protected. The modern tendency is to assimilate the rights of the buyer and seller in the conditional sale to those of chattel mortgagor and mortgagee. In a few states forfeiture is done away with by legislation. In the Uniform Conditional Sales Act there is a provision whereby the buyer may redeem the goods (§18) from the seller within a limited period after the latter retakes possession, and in case the buyer does not so redeem there are provisions for the resale by the seller (§§19-20). This statutory scheme for relieving the buyer of the hardship of

forfeiture is simply following out the doctrines which equity developed with respect to mortgages.

The theory that a conditional sale is in practical effect a sale to the buyer with a mortgage back to secure the price finds further illustration in the rule followed by most courts and now embodied in the Uniform Sales Act that if the goods are accidentally destroyed or injured after delivery of possession, the buyer must stand the loss and must pay the price in full at the time agreed.

Under the common law in nearly all the states persons who rely on the buyer's apparent ownership receive no protection. Inasmuch as the seller is the owner he is permitted, upon the buyer's default, to retake possession of the goods no matter into whose hands they might have passed. To prevent injury to innocent purchasers, mortgagees or pledgees from the buyer, about thirty states have enacted legislation requiring the filing of Conditional Sale Contracts in a public office, but these statutes, of course, vary in their practical details. Many of these statutes also expressly protect creditors who levy upon or attach the goods, if they are without notice of the seller's title.

In an attempt to evade the recording acts applicable to Conditional Sales, sellers of goods sometimes make a "lease" by the terms of which the buyer binds himself to pay "rent" equal to the price of the goods, with the option of becoming owner after the last "rental payment" has been made. The courts, however, usually look through the form to the substance of this transaction and hold such a so-called "lease" to be a conditional sale contract.

§292 *FRANCISCO v. RYAN.*

Supreme Court of Ohio, 1896. [54 *Ohio St.* 307.]

WILLIAMS, C. J.: The record shows that William R. Ryan, the defendant in error, sold a stock of drugs and merchandise consisting of such articles as are usually kept in a retail drug store, to Eugene Louselle, who gave Ryan a mortgage on the property to secure the payment of three notes, maturing at different dates, and which were given by the mortgagor for the purchase price of the goods. The mortgage, which was duly executed, verified, and filed with the proper officer, contained

the following stipulation: "It is hereby understood that whatever portions of said stock that may be sold in general trade, that the goods purchased by the said grantor shall replace those that were so sold in general trade, and that this mortgage shall be a lien on same. To have and to hold all and singular the goods, chattels and property above granted, bargained and sold, or intended to be granted, bargained and sold unto the said grantee, his heirs and assigns." It contained the further stipulation that if default should be made in the payment of either of the notes, or if before such default the mortgagee should "deem it necessary for his more complete and perfect security, he is hereby authorized and empowered to enter the store or other place where the goods may be, and take and carry away said mortgaged property, and sell and dispose of the same at public or private sale, and out of the money arising therefrom to retain and pay the mortgage debt, and all charges touching the same, together with a sufficient sum to indemnify the mortgagee for any damages sustained by him by reason of any of the covenants of the mortgagor, rendering the overplus, if any, to the mortgagor." After the execution and filing of the mortgage, the mortgagor, who retained possession of the stock of goods included in the mortgage, sold at retail therefrom, and from time to time added to the stock other goods purchased to supply the place of those sold; and he thus continued in possession, carrying on the business until the last mortgage note matured, when the mortgagee, after calling several times to see the mortgagor and failing to find him, and becoming apprehensive of his security, took possession of the mortgaged property, including the property purchased to supply the place of what had been sold by the mortgagor. When that had been done, and while the mortgagee was so in possession, the plaintiff in error, Francisco, who was a constable, levied an attachment on the property issued against the mortgagor at the suit of the other plaintiffs in error who were creditors of the mortgagor, and took the property into his custody under the writ. Thereupon Ryan brought the action below to replevin the goods, obtained their possession, sold the same, and applied the proceeds to the payment of the mortgage indebtedness. The attaching creditors, who were made parties to that action, set up their claims, controverted the right of the mortgagee to the property, and prayed judgment accordingly. . . . The alleged infirmities of the mortgage are: (1) That it gave the mortgagor power to sell in the usual course of business while in possession of the mortgaged property, and is therefore void; (2) That it was ineffectual to create any lien on that part of the property

which was acquired by the mortgagor after the execution of the mortgage, and the mortgagee's possession, though taken prior to the levy of the attachment, did not cure the defect, because it was not delivered by, nor obtained with the consent of the mortgagor; and (3) That it conferred no authority on the mortgagee to take possession of such after-acquired property.

1. A diversity of opinion has been expressed, and is entertained in regard to the effect of a power of sale reserved to a mortgagor of chattel property who remains in possession of the same.

It is said by Campbell, J., in *Gay v. Bidwell,* 7 Mich. 519, 525, that "no court has given any satisfactory reason why such a provision should necessarily vitiate a chattel mortgage, although it is undoubtedly liable to abuse. The recording law enables a vigilant person to ascertain the existence of such securities. Many small merchants, especially beginners in the business, have no other means of securing their creditors for the stock they purchase, and can only meet their debts out of current sales. If any creditor is likely to be injured by allowing the debtor to dispose of the mortgaged property, it is rather the creditor whose security is thus cut down, than the one who has no claim on the specific property. To hold that a merchant cannot mortgage his goods without closing his doors would be to hold that no mortgage of a merchant's stock can be made at all." And in a late case, *Etheridge v. Sperry,* 138 U. S., 266, it is said by Mr. Justice Brewer, speaking of a power of sale by a mortgagor of chattels in possession, that: "If this were an open question, we could not be blind to the fact that the tendency of this commercial age is toward increased facilities in the transfer of property, and to uphold such transfers so far as they are made in good faith;" that, "the interests of the general public are not prejudiced by any such transaction between debtor and creditor;" and that, if the question were "a new one, unaffected by any settled law of the state, we incline to the opinion that the question is not one of law, so much as it is one of fact and good faith." . . .

In the case of *Brown v. Webb,* 20 Ohio, 389, it is decided that while such a mortgage, with possession and a power of sale in the mortgagor is void as against subsequent purchasers from the mortgagor, yet "when possession is taken by the mortgagee, the mortgage becomes valid so as to protect the mortgaged property from execution creditors not having made a levy, and against subsequent purchasers from the mortgagor." Possession so taken by the mortgagee has the effect of completing his title, and relieving the property from liability to seizure at the suit

of the mortgagor's creditors. That rule has not been qualified or questioned in any subsequent case, but is rather confirmed by that of *Webb v. Brown*, 3 Ohio St., 246, where it is said by Warden, J., that "the doctrine which is to be collected from authority and reason seems to be that a sale of goods, made with intent to defraud the vendor's creditors, is absolutely void, only against the legal process of the creditor;" and that "the utmost concession allowed by law to the interests of creditors leaves it still certain that until seizure by a creditor's writ, the fraudulent vendee can do with the property all that the vendor might have done had he retained the goods." Before such seizure it is competent for the debtor, in good faith, and for value, to sell and deliver the property to any one who is willing to purchase it, or transfer the same to a creditor in payment of or security for a *bona fide* debt; and when so transferred it is beyond the reach of the other creditors of the mortgage; and it cannot be material in this respect whether the transfer is the result of an agreement made at the time, or is in performance of a previous agreement binding on the parties. And, as some doubt appears to be entertained in regard to the proper scope of the rule, especially in a case like the one before us, we now hold that a mortgage given in good faith, on a stock of merchandise, to secure a *bona fide* debt of the mortgagor, is valid as between the parties, although the mortgagor be permitted to continue in possession of the property with the power to sell therefrom in the usual course of business; and, while such a mortgage is invalid as against the creditors of the mortgagor who cause the property to be seized on legal process while it remains in his possession, and purchasers who become such during that time, when the mortgagee takes the possession of the property, either with the consent of the mortgagor given at the time, or in pursuance of a stipulation of the mortgage authorizing it, his title becomes complete and the property is no longer subject to legal process issued against the mortgagor, nor liable for his debts except to the extent of any surplus remaining after the satisfaction of the mortgage debt and proper charges resulting from its enforcement. That the mortgage involved in this case was made in good faith, to secure a debt justly owing to the mortgagee, is not questioned; and it appears that he had taken possession of the mortgaged property before the constable levied the attachment thereon, and was in actual possession when the levy was made; so that he was entitled to hold the property as against the claim of the attaching creditor, so far as his right could be affected by the question now under consideration.

2. The mortgage in question, as has before been noticed, contains a provision to the effect that it shall be a lien on any goods that the mortgagor should add to the stock to supply the place of those sold in the course of his business; and it appears that some articles so added constituted part of the stock when the mortgagee took possession of the same; and, as to those articles, it is contended the mortgage created no lien, and the mortgagee's possession gave him no right to them; and further, that because they were so commingled with the balance of the stock as to be indistinguishable and inseparable, his possession of all the property was illegal, and it was, therefore, liable to be taken under the attachment which was levied on it.

Courts have differed in regard to the effect of mortgages intended to create a lien on goods which the mortgagor did not own at the time of its execution, but which it was contemplated he would thereafter acquire. This difference has arisen chiefly from the nature of the jurisdiction exercised by the courts. Those of equitable cognizance applying the maxim that equity regards that as done which ought to be done, hold that under such a mortgage a lien attaches to the property as soon as it comes to the mortgagor's ownership; while at law, it has been held that it creates no present lien, nor one as the property is acquired, but as between the parties it operates only as a contract for a lien, which may be made effectual for the benefit of the mortgagee by possession lawfully obtained of the property, not only as against the mortgagor himself, but also as against any subsequent legal process issued against him, or disposition attempted to be made by him. Whether, or in what instance, in actions under a civil code like ours, by which the two systems of remedial justice are blended and administered in the same courts, and often in the same proceeding, the equitable rule should be applied, is a question upon which the courts are not agreed, and one whose decision is not necessary in this case. In the case of *Chapman v. Weimer*, 4 Ohio St., 481, the court followed the rule at law, holding that: "A chattel mortgage, purporting to create a lien on the stock in a grocery, and also on such as should be subsequently acquired by the mortgagor, creates no lien on the subsequently acquired property;" but, "when such mortgage authorizes the mortgagee to take possession of the property secured and attempted to be secured, it is a continuing executory contract; and when the mortgagor acquires such property after the execution of the mortgage, and actually delivers the same to the mortgagee, the latter thereby acquires a valid lien on such subsequently acquired property." . . .

3. It is further claimed that the mortgage involved in this case did not authorize the mortgagee to take possession of the property which was purchased by the mortgagor to supply the place of that sold by him, the authority being to take possession of the "mortgaged property," which, it is contended, does not include that so purchased. As has been noticed, however, the mortgage purports to create a lien on the property so purchased by the mortgagor, as well as on the stock owned by him when it was executed, and it was evidently intended by the parties to have that effect. It is but a reasonable interpretation of the instrument, therefore, looking to all its provisions, that by the phrase "mortgaged property" in the subsequent clause, the parties meant all property which they intended and agreed should be covered by the mortgage. That interpretation is necessary to give full effect to all its parts, and accomplish the manifest purpose and intention of the parties.

The seizure clause in chattel mortgages is inserted for the benefit and protection of the mortgagee; and when, like the one in this case, it authorizes him to take the property when he deems it necessary for his better security, he may take it whenever, in his judgment, it is best for him to do so; and the rightful exercise of that authority does not depend upon the fact that he has reasonable grounds for deeming it necessary for his security. As said in *Werner v. Bergman,* 28 Kans., 60, 64, "if the mortgagor wishes to retain possession of the property until the mortgagee shall have reasonable grounds to deem himself insecure, he can insert, or have inserted, a stipulation to that effect in the mortgage; or if he wishes to go still further, and retain possession of the property until the mortgagee shall become in fact insecure, he can have a stipulation put in the mortgage to that effect. But if he chooses only to have inserted in the mortgage a clause that he shall have the right to the possession of the property until the mortgagee deems himself insecure, then he can only retain the property until the mortgagee does in fact deem himself insecure; and he has no right to question the grounds upon which the mortgagee entertains such feeling of insecurity." Finding no error in the record, the

Judgment is affirmed.

§293. *"Fluid" Mortgage Res.*—On the effect upon the validity of a mortgage of merchandise of a provision or agreement giving the mortgagor the possession with power of sale, see notes in 18 L. R. A. 604 and 36 L. R. A. (N. S.) 1181; and *cf. Boice v. Finance and Guaranty Corp.* (1920),

102 S. E. 591 (Supreme Ct. of App. of Va.). See also Sec. 9, of Uniform Conditional Sales Act. quoted in §201, *supra.*

On the validity of the "after-acquired property clause" in mortgages, see the notes in 1 L. R. A. (N. S.) 451, 21 L. R. A. (N. S.) 843, and 25 L. R. A. (N. S.) 117.

§294 *INGELL v. FAY.*

Supreme Judicial Court of Massachusetts, 1873. [112 *Mass.* 451.]

Contract brought by the plaintiffs as administrators of the estate of Zadoc Ingell, deceased, to recover the price of a quantity of timber sold by the plaintiffs to the defendant. The writ was dated April 17, 1872.

At the trial in the Superior Court, before Allen, J., the delivery of the timber and the price charged, and that the timber was cut by the intestate upon his farm a short time previous to his death, and was lying where it was cut at the time of his death, were admitted, but the defendant contended that it was the property of one William E. Moore.

There was evidence tending to show that the intestate died January 22, 1871; and that the timber was sold and delivered to the defendant by the plaintiffs in May, or June, 1871.

The defendant put in evidence a mortgage deed from the intestate to Moore of the premises upon which the timber was cut. This mortgage was dated April 1, 1867, and contained the following proviso: "Provided, nevertheless, and this deed is on the following condition, that whereas I, the said Zadoc Ingell, have executed one promissory note of hand bearing even date herewith for twenty-three hundred dollars payable in wood to said William E. Moore or order, cut and delivered at the Western Railroad track or depot in Chester, or either place as said Moore or his agent shall elect, within five years from this date, one hundred and fifteen cords each and every year until paid according to the tenor of said note, said Ingell not to cut wood or timber upon said estate, except for the payment of said note, to reduce the value below the amount secured with interest annually: Therefore if I, the said Zadoc Ingell, or my representatives shall pay the full amount of said note according to the tenor thereof, then this deed shall be void; otherwise in full force." On the back of the mortgage was a duly executed and recorded certificate of two witnesses to prove an entry to foreclose the mortgage for a breach of the condition. Upon the note

mentioned in the mortgage deed were several indorsements of wood received in part payment, the last indorsement being dated March 1, 1869. It was admitted that no payments had been made upon the note except those that were indorsed upon it. . . .

The defendant requested the court to instruct the jury that Moore was entitled as mortgagee, under the facts admitted and not in dispute, to the proceeds of the timber, and that the plaintiffs could not maintain the action; and also, if they were satisfied that the value of the mortgaged premises at the commencement of the action was less than the amount of the mortgage debt at that time, they could not maintain the action.

The court declined to give these instructions, but instructed the jury that if the value of the premises, at the time of the sale and delivery to the defendant, was less than the amount of the mortgage debt then due, and if the plaintiffs sold the timber for their own benefit or that of the estate, and not for the benefit of Moore, the plaintiffs could not recover for the value of the timber; but if the value of the premises, at the time of the sale and delivery, was greater than the amount of the mortgage debt at that time, the plaintiffs were entitled to recover the value of the timber. The jury found for the plaintiffs, and the defendant excepted.

AMES, J.: By the terms of the mortgage, the intestate had a right to cut wood and timber upon the mortgaged premises whenever he saw fit, and to any extent, subject only to the limitation that he should not at any time so strip the land as to leave it less in value than the amount due at the time upon the mortgage. It is settled by the verdict of the jury that the sale of the timber to the defendants, for which payment is sought in this suit, was not a violation of this condition. This was the only question in the case, and it was submitted to the jury with instructions sufficiently favorable to the defendant. If after the sale and delivery of the timber, the remaining value of the land exceeded the amount then due upon the mortgage, the mortgagee had no right to claim either the timber or its proceeds.

Exceptions overruled.

§295. *Intent in Mortgages.*—These and similar details with reference to the *use of the property* are, in spite of the highly standardized nature of the mortgage, controlled by the intent of the parties.

§296. *CURTISS v. SHELDON.*

Supreme Court of Michigan, 1892. [91 *Mich.* 390.]

GRANT, J.: Complainants filed a bill to redeem. Decree was entered for them, and defendant appealed to this court, which affirmed the decree below. *Curtiss v. Sheldon,* 47 Mich. 262, 11 N. W. Rep. 151. The case was remanded for an accounting, and complainants now appeal from the decree fixing the amount due to the defendant. The accounting was in exact accord with the first decree, which was affirmed by this court. Complainants now attack this decree on two grounds, viz.: (1) Because it allows the defendant 10 per cent. on his loan to them; and (2) because it held defendant accountable for the rents actually received, instead of the rents which they insist defendant might have received.

1. The rate of interest was fixed by the parties, and 10 per cent. was at that time a legal and very common rate of interest. Courts possess no power, legal or equitable, to change the terms of contracts. No claim is made that there was any misrepresentation or fraud in fixing the rate of interest.

2. The property was occupied as an hotel, and it is insisted that the defendant might have realized a greater rent if he had permitted the lessee to keep a bar for the sale of liquors. Prior to 1875 the sale of liquors in this state was unlawful, and defendant clearly could not be held for refusing to permit the property to be used for an unlawful purpose. Since 1875 the sale of liquor has been lawful under very stringent regulations. Undoubtedly buildings can be rented for saloon purposes in many localities at higher rents than for other kinds of business. *Non sequitur* that the law imposed a duty upon Mr. Sheldon to lease the property for that purpose.

3. The decree in this case limits the amount due from complainants to the sums actually advanced, and to the cost of the improvements, taxes, and insurance. From this amount is deducted the amount actually received by Mr. Sheldon for rents. After the execution of the deed to him, he believed that he owned the property. It was clearly to his advantage to realize all he could from the use of the property. The record shows, in my judgment, that he acted in good faith in renting the property, and exercised ordinary care and prudence in that regard. It is immaterial whether he was a mortgagee, trustee, or agent of the complainants. He was in possession by their consent, under a deed from them. At the time this deed was executed, complainants and Mr. Sheldon made a written agreement, by which he agreed to use reasonable diligence to sell the

property within one year at a price that should be concurred in by both parties, pay himself the sums mentioned in the agreement, with interest at 10 per cent. per annum and pay the surplus to complainants. This agreement was at the time deposited with a third party, and appears to have been forgotten until the accounting before the commissioner, when it was produced by the party with whom it had been left. It is material to mention it here only to show the relations of the parties and the conditions under which Mr. Sheldon accepted the deed. Mr. Curtiss, who is the assignee of Martin Mosher, by his own evidence relieves Mr. Sheldon from any charge of fraud or willful neglect. When questioned as to the reason why Mr. Sheldon could not get as much for the premises as he (the witness) could get, he replied: "Because he did not know how to do it." He also testified that he had not informed him that any person would give a larger rent. It is unnecessary to discuss the question of fraud charged by the complainants against Mr. Sheldon, claiming that, in the settlements at and prior to 1872, he represented the amounts due from complainants to be larger than they actually were. By the former decree, these settlements were set aside, and the complainants allowed to redeem upon the basis of the original amounts. The decree is affirmed. Defendant will recover costs in this court, and complainants will recover the costs in the court below. The other justices concurred.

§297 *TURNER v. MEBANE.*

Supreme Court of North Carolina, 1892. [110 *N. C.* 413.]

CLARK, J.: The defendant mortgagor moved the house from the mortgaged premises across the road to another tract, also belonging to him but not covered by the mortgage. This certainly could not impair the mortgage lien upon the house. If it could, in these days when house-moving machinery has been so greatly perfected, there would be a serious impairment of the security of all mortgages on improved real estate. The Court decreed a sale of the house in its new *situs* under the mortgage, with leave to the purchaser to remove, or roll the building off again. We can perceive no grounds, legal or equitable, upon which the defendant can object to this. The plaintiff does not ask for more, and the rights of third parties are not involved.

It does not appear that the building was attached to the freehold, and it is unnecessary to discuss the effect of such attachment in this case, if any.

No error.

§298. *The Conveyance Theory and its Application.*—In order to do substantial justice in this case, the court departs somewhat from the conveyance theory of the mortgage, which is in force in North Carolina, and works out the rights of the parties on the basis of agreement. The following case illustrates, however, the rigidity with which the distribution of rent of the mortgaged property is made to depend upon possession, entirely independent of any question of contract.

§299 *TEAL v. WALKER.*

United States Supreme Court, 1884. [111 *U. S.* 242.]

On July 6, 1877, the interest on the note being in arrear since January 21st preceding, Hewett demanded of Teal the possession of all the property conveyed by said deeds. He refused to yield possession, and held the lots in the city of Portland until November 30, 1878, and the farm lands until some time in the same month and year.

Walker, by reason of [Teal's] refusal to surrender possession of the property conveyed in trust to Hewett, was compelled to and did bring suit to enforce the sale of the property. All the property was sold, either in accordance with the terms of the defeasances above mentioned or by order of court, and the proceeds of the sale fell far short of paying the note, leaving a balance due thereon of more than $50,000, which Goldsmith had no means to pay.

This action was brought by Walker, the payee of the note, against Teal, to recover the damages which he claimed he had sustained by the refusal of Teal to surrender possession of the property of which Goldsmith had been the owner, or which he had owned jointly with Teal, and which had been conveyed to Hewett in trust as aforesaid. The complaint recited the facts above stated, and averred that by reason of the refusal of Teal to surrender possession of the property to Hewett, Walker had been damaged in the sum of $16,000, for which sum the complainants demanded judgment.

Mr. Justice WOODS delivered the opinion of the court. He stated the facts in substance as above, and continued:

We believe that the rule is without exception that the mortgagee is not entitled to demand of the owner of the equity of redemption the rents and profits of the mortgaged premises until he takes actual possession. In the case of *Moss v. Gallimore,* 1 Doug. 279, Lord Mansfield held that a mortgagee, after

giving notice of his mortgage to a tenant in possession holding under a lease older than the mortgage, is entitled to the rent in arrear at the time of the notice, as well as to that which accrues afterwards. This ruling has been justified on the ground that the mortgagor, having conveyed his estate to the mortgagee, the tenants of the former became the tenants of the latter, which enabled him, by giving notice to them of his mortgage, to place himself to every intent in the same situation towards them as the mortgagor previously occupied. *Rawson v. Eicke,* 7 Ad. & El. 451; *Burrowes v. Gradin,* 1 Dowl. & Loundes, 213.

Where, however, the lease is subsequent to the mortgage, the rule is well settled in this country, that, as no reversion vests in the mortgagee, and no privity of estate or contract is created between him and the lessee, he cannot proceed, either by distress or action, for the recovery of the rent. *Mayo v. Shattuck,* 14 Pick. 533; *Watts v. Coffin,* 11 Johns. 495; *McKircher v. Hawley,* 16 Johns. 289; *Sanderson v. Price,* 1 Zabr. 637; *Price v. Smith,* 1 Green's Ch. (N. J.) 516.

The case of *Moss v. Gallimore* has never been held to apply to a mortgagor or the vendee of his equity of redemption. Lord Mansfield himself, in the case of *Chinnery v. Blackman,* 3 Doug. 391, held that until the mortgagee takes possession the mortgagor is owner to all the world, and is entitled to all the profits made.

The rule on this subject is thus stated in Bacon's Abridgment, Title Mortgage C: "Although the mortgagee may assume possession by ejectment at his pleasure, and according to the case of *Moss v. Gallimore,* Doug. 279, may give notice to the tenants to pay him the rent due at the time of the notice, yet, if he suffers the mortgagor to remain in possession or in receipt of the rents, it is a privilege belonging to his estate that he cannot be called upon to account for the rents and profits to the mortgagee, even although the security be insufficient."

So in *Higgins v. York Buildings Company,* 2 Atk. 107, it was said by Lord Hardwicke: "In case of a mortgagee, where a mortgagor is left in possession, upon a bill brought by the mortgagee, for an account in this court, he never can have a decree for an account of rents and profits from the mortgagor for any of the years back during the possession of the mortgagor," and the same judge said in the case of *Mead v. Lord Orrery,* 3 Atk. 244: "As to the mortgagor, I do not know of any instance where he keeps in possession that he is liable to account for the rents and profits to the mortgagee, for the mortgagee ought to take the legal remedies to get into possession."

In *Wilson, ex parte,* 2 Ves. & B. 252, Lord Eldon said:

"Admitting the decision in *Moss v. Gallimore* to be sound law, I have been often surprised by the statement that a mortgagor was receiving the rents for the mortgagee. . . In the instance of a bill filed to put a term out of the way which may be represented as in the nature of an equitable ejectment, the court will, in some cases, give an account of the past rents. There is not an instance that a mortgagee has *per directum* called upon the mortgagor to account for the rents. The consequence is, that the mortgagor does not receive the rents for the mortgagee." See also, *Coleman v. Duke of St. Albans,* 3 Ves. Jr. 25; *Gresley v. Adderly,* 1 *Swanst.* 573.

The American cases sustain the rule that so long as the mortgagor is allowed to remain in possession, he is entitled to receive and apply to his own use the income and profits of the mortgaged estate; and although the mortgagee may have the right to take possession upon condition broken, if he does not exercise the right, he cannot claim the rents; if he wishes to receive the rents, he must take means to obtain the possession. *Wilder v. Houghton,* 1 Pick. 87; *Boston Bank v. Reed,* 8 Pick. 459; *Noyes v. Rich,* 52 Me. 115.

In *Hughes v. Edwards,* 9 Wheat. 500, it was held that a mortgagor was not accountable to the mortgagee for the rents and profits received by him during his possession, even after default, and even though the land, when sold, should be insufficient to pay the debt, and that the purchaser of the equity of redemption was not accountable for any part of the debt beyond the amount for which the land was sold.

In the case of *Gilman v. Illinois & Mississippi Telegraph Company,* 91 U. S. 603, it was declared by this court that where a railroad company executed a mortgage to trustees on its property and franchises, "together with tolls, rents, and profits to be had, gained, or levied thereupon," to secure the payment of bonds isued by it, the trustees, in behalf of the creditors, were not entitled to the tolls and profits of the road, even after condition broken, and the filing of a bill to foreclose the mortgage, they not having taken possession or had a receiver appointed. The court said, in delivering judgment in this case: "A mortgagor of real estate is not liable for rent while in possession. He contracts to pay interest, not rent." So in *Kountze v. Omaha Hotel Company,* 107 U. S. 378, it was said by the court, speaking of the rights of a mortgagee: "But in the case of a mortgage, the land is in the nature of a pledge; it is only the land itself, the specific thing, which is pledged. The rents and profits are not pledged; they belong to the tenant in possession, whether the mortgagor or third person claims

under him. . . The plaintiff in this case was not entitled to the possession, nor the rents and profits.'' See also *Hutchins v. King,* 1 Wall. 53, 57-58.

Chanceller Kent states the modern doctrine in the following language: ''The mortgagor has a right to lease, sell, and in every respect to deal with the mortgaged premises as owner so long as he is permitted to remain in possession, and so long as it is understood and held that every person taking under him, takes subject to all the rights of the mortgagee, unimpaired and unaffected. Nor is he liable for rents, and the mortgagee must recover the possession by regular entry by suit before he can treat the mortgagor, or the person holding under him, as a trespasser.'' 4 Kent. *Com.* 157. See also *American Bridge Company v. Heidelbach,* 94 U. S. 798; *Clarke v. Curtis,* 1 Grattan, 289; *Bank of Ogdensburg v. Arnold,* 5 Paige Ch. 38; *Hunter v. Hays,* 7 Biss. 362; *Souter v. La Crosse Railway,* Woolworth C. C. 80, 85; *Foster v. Rhodes,* 10 Bank. Reg. 523. The authorities cited show that, as the defendant in error took no effectual steps to gain possession of the mortgaged premises, he is not entitled to the rents and profits while they were occupied by the owner of the equity of redemption.

The case against the right of the defendant in error to recover in this case the rents and profits received by the owner of the equity to redemption is strengthened by section 328, chapter 4, title 1, General Laws of Oregon, 1843-1872, which declares that ''a mortgage of real property shall not be deemed a conveyance so as to enable the owner of the mortgage to recover possession of the real property without a foreclosure and sale according to law.''

This provision of the statute cuts up by the roots the doctrine of *Moss v. Gallimore, ubi supra,* and gives effect to the view of the American courts of equity that a mortgage is a mere security for a debt, and establishes absolutely the rule that the mortgagee is not entitled to the rents and profits until he gets possession under a decree of foreclosure. For if a mortgage is not a conveyance, and the mortgagee is not entitled to possession, his claim to the rents is without support. This is recognized by the Supreme Court of Oregon as the effect of a mortgage in that State. In *Besser v. Hawthorn,* 3 Oregon, 129, at 133, it was declared: ''Our system has so changed this class of contracts that the mortgagor retains the right of possession and the legal title.'' See, also, *Anderson v. Baxter,* 4 Ore. 105; *Roberts v. Sutherlin,* id. 219.

The case of the defendant in error cannot by aided by the stipulation in the defeasance of August 19, 1874, exacted by the

mortgagee that Goldsmith and Teal would, upon default in the payment of the note secured by the mortgage, deliver to Hewett, the trustee, the possession of the mortgaged premises. That contract was contrary to the public policy of the State of Oregon, as expressed in the statute just cited, and was not binding on the mortgagor or his vendee, and although not expressly prohibited by law, yet, like all contracts opposed to the public policy of the state, it cannot be enforced. *Railroad Company v. Lockwood,* 17 Wall. 357; *Bank of Kentucky v. Adams Express Company,* 93 U. S. 174; *Marshall v. Baltimore & Ohio R. R. Co.* 16 How. 314; *Meguire v. Corwine,* 101 U. S. 108.

In any view of the case, we are of opinion that the defendant in error was not entitled to receive the rents sued for in this action. As this conclusion takes away the foundation of the suit, it is unnecessary to notice other assignments of error.

The judgment of the Circuit Court is reversed, and the cause remanded to that court for further proceedings in conformity with this opinion.

§300 *NOAKES & CO., LTD. v. RICE.*

House of Lords, 1902. [1902, *A. C.* 24.]

The respondent, a licensed victualler, in 1897 bought a public-house held under a lease expiring in 1923. Before the purchase the appellants, who were brewers, had a mortgage on the house with a covenant similar to the one now in question. The appellants released their security to enable the second mortgagees to sell the house. The respondent not being able to find all the purchase-money, part was advanced by the appellants upon a mortgage by the respondent of the leasehold premises, good-will, etc., subject to a proviso that if the respondent should pay all the moneys and interest due on the security the appellants should surrender or re-convey the premises to the respondent or as he should direct. In the mortgage deed the respondent covenanted, in the terms more fully set forth in both the reports below [1900], 1 Ch. 213; [1900] 2 Ch. 445; to the effect that, so as to charge the premises into whosesoever possession they might come, and to the intent that the obligation of the covenant might run with the land, the respondent would not at any time during the continuance of the term, whether any money should or should not be owing on the security, use or sell upon the premises any malt liquors except such as should be purchased by the respondent of the appellants.

The respondent being desirous to pay off all money due on the security and to obtain a reconveyance or transfer, with a

release from the covenant in question, brought an action against the appellants, claiming a declaration to that effect.

COZENS-HARDY, J., made an order declaring that upon payment by the respondent to the appellants of all moneys due, the respondent was entitled to a reconveyance of the property together with a release of all covenants contained in the mortgage, or at his option to have the property transferred to a transferree with the benefit of all covenants contained in the mortgage; and that in either case the appellants were not thereafter entitled to the benefit of the covenant in question. This order was affirmed by the Court of Appeal (Lord ALVERSTONE, M. R., RIGBY, and COLLINS, L. J. J.).

LORD DAVEY.: My Lords, there are three doctrines of the courts of equity in this country which have been referred to in the course of the argument in this case. The first doctrine to which I refer is expressed in the maxim: "Once a mortgage always a mortgage." The second is that the mortgagee shall not reserve to himself any collateral advantage outside the mortgage contract; and the third is that a provision or stipulation which will have the effect of clogging or fettering the equity of redemption is void.

My Lords, the first maxim present no difficulty; it is only another way of saying that a mortgage cannot be made irredeemable, and that a provision to that effect is void. In the case of the *Marquis of Northampton v. Salt,* [1892] A. C. 1, the question was whether a certain life policy, the premiums on which were charged against the mortgagor, was comprised in the mortgage security. That question having been decided in the affirmative, it was declared to be redeemable, notwithstanding an express provision to the contrary contained in the deed.

My Lords, the second doctrine to which I refer, namely, that the mortgagee shall not reserve to himself any collateral advantage outside the mortgage contract, was established long ago when the usury laws were in force. The Court of Equity went beyond the usery laws, and set its face against every transaction which tended to usury. It therefore declared void every stipulation by a mortgagee for a collateral advantage which made his total renumeration for the loan indirectly exceed the legal interest. I think it will be found that every case under this head of equity was decided either on this ground, or on the ground that the bargain was oppressive and unconscionable. The abolition of the usury laws has made an alteration in the view the court should take on this subject, and I agree that a collateral advantage may now be stipulated for by a mortgagee,

provided that no unfair advantage be taken by the mortgagee which would render it void or voidable, according to the general principles of equity, and provided that it does not offend against the third doctrine. On these grounds I think the case of *Biggs v. Hoddinott,* [1898] 2 Ch. 307, in the Court of Appeal was rightly decided.

The third doctrine to which I have referred is really a corollary from the first, and might be expressed in this form: Once a mortgage, always a mortgage, and nothing but a mortgage. The meaning of that is that the mortgagee shall not make any stipulation which will prevent a mortgagor, who has paid principal, interest, and costs, from getting back his mortgaged property in the condition in which he parted with it. I do not dissent from the opinion expressed by my noble and learned friend opposite (Lord Lindley) when Master of the Rolls, in the case of *Santley v. Wilde,* [1899] 2 Ch. 474. He says: "A clog or fetter is something which is inconsistent with the idea of security; a clog or fetter is in the nature of a repugnant condition." But I ask, "security" for what? I think it must be security for the principal, interest, and costs, and, I will add, for any advantages in the nature of increased interest or renumeration for the loan which the mortgagee has validly stipulated for during the continuance of the mortgage. There are two elements in the conception of a mortgage: first, security for the money advanced; and, secondly, renumeration for the use of the money. When the mortgage is paid off the security is at an end, and, as the mortgagee is no longer kept out of his money, the remuneration to him for the use of his money is also at an end. I confess I should have decided the case of *Santley v. Wilde, supra,* differently from the way in which it was dealt with in the Court of Appeal. After the payment of principal and interest, and everything which had become payable up to the date of redemption, the property in that case remained charged with the payment to the mortgagee of one-third share of the profits, and the stipulation to that effect should, I think, have been held to be a clog or fetter on the right to redeem. The principle is this—that a mortgage must not be converted into something else; and when once you come to the conclusion that a stipulation for the benefit of the mortgagee is part of the mortgage transaction, it is but part of his security, and necessarily comes to an end on the payment off of the loan. In my opinion, every yearly or other recurring payment stipulated for by the mortgagee should be held to be in the nature of interest, and no more payable after the principal is paid off than interest would be. I apprehend a man could not

stipulate for the continuance of payment of interest after the principal is paid, and I do not think he can stipulate for any other recurring payment such as a share of profits. Any stipulation to that effect would, in my opinion, be void as a clog or fetter on the equity of redemption.

By the Conveyancing Act a mortgagee may now be required to transfer his mortgage on payment of what is due to him, and he must then transfer all his security, including every advantage which he derives from the mortgage transaction, and all his deeds and documents constituting his title as mortgagee. And on redemption he must do the like to the mortgagor, and any stipulation which varies the effect and incident of redemption on payment off of what is due on the loan is a clog within the meaning of the rule.

Now, applying what I have said to the present case, the decision becomes easy. In the first place, I do not think that the respondent's covenant to deal exclusively with the brewers continued after the payment off of the loan and the redemption; and, secondly, if it did, it was an attempt to charge it on the property, and that constituted a clog or fetter which, according to well-established principles, was void.

My Lords, I only desire to add that, with my noble and learned friend by my side (LORD MACNAGHTEN), I cannot assent altogether to the assumption made by COZENS-HARDY, J., that the covenant constituted or might constitute a good charge upon the property by virtue of the operation of the doctrine in *Tulk v. Moxhay* (1848), 2 Ph. 774. I should hesitate some time before I assented to that proposition; but it is perfectly immaterial for the decision in the present case, because, as I have already said, I think that the covenant did not continue after the redemption, and that the mere attempt to make it a charge on the property would render it void.

My Lords, upon these grounds I agree with the motion proposed by my noble and learned friend.

§301 *BARRETT v. HINKLEY.*

Supreme Court of Illinois, 1888. [124 *Ill.* 32.]

MULKEY, J.: Watson S. Hinkley, claiming to be the owner in fee of the land in controversy, on the twenty-sixth day of February, 1885, brought an action of ejectment in the superior court of Cook County against the appellants, George D. Barrett, Adalina S. Barrett, William H. Whitehead, and others, to recover the possession thereof. There was a trial of the cause before the court without a jury, resulting in a finding

and judgment for the plaintiff, and the defendants appealed. The evidence tends to show the following state of facts: In 1870, Thomas Kearns was in possession of the land, claiming to own it in fee-simple. On August 3d of that year he sold and conveyed it to William H. W. Cushman for the sum of $80,000. Cushman gave his four notes to Kearns for balance of purchase money—one for $12,500, maturing in 30 days; three for $16,875 each, maturing, respectively in two, three, and four years after date—and all secured by a mortgage on the premises. The notes seem to have all been paid but the last one. In 1878, Kearns died, and his widow, Alice Kearns, administered on his estate. Previous to his death, however, he had hypothecated the mortgage and last note to secure a loan from Greenebaum. Subsequently, and before the commencement of the present suit, Greenebaum, in his own right, and Mrs. Kearns, as administratrix of her husband, for value, sold and assigned by a separate instrument in writing the mortgage and note to the appellee, Watson S. Hinkley. This is in substance the case made by plaintiff. The defendants showed no title in themselves or any one else. The conclusion to be reached, therefore, depends upon whether the case made by the plaintiff warranted the court below in rendering the judgment it did. . . .

It is first to be specially noted that this is a suit at law, as contra-distinguished from a suit in equity. It is brought to enforce a naked legal right, as distinguished from an equitable right. The plaintiff seeks to recover certain lands, the title whereof he claims in fee-simple. To do this he is bound to show in himself a fee-simple title at law, as contra-distinguished from an equitable fee. *Fischer v. Eslaman*, 68 Ill. 78; *Wales v. Bogue*, 31 Ill. 464; *Fleming v. Carter*, 7 Ill. 286; *Dawson v. Hayden*, 67 Ill. 52. Has he done this? He attempts to derive title remotely through the mortgage from Cushman to Kearns, but upon what legal theory is not very readily perceived. His immediate source of title, however, seems to be Mrs. Kearns, as administratrix of her husband, and Greenebaum, as pledgee of the note and mortgage. The instrument through which he claims is lost or destroyed, and all we know concerning its character is what the plaintiff himself says about it. As to its contents, he does not pretend to state a single sentence or word in it, but characterizes it as an assignment, and gives the conclusions which he draws from it in general terms only. After stating his purchase of the note and mortgage in January, 1880, he says: "The assignment was from Mrs. Kearns, the administratrix of Thomas Kearns's estate, and Elias Greenebaum, the banker. At the time of the purchase, a separate writing was given to me—a full assignment. . . . It was a very explicit

assignment, or full assignment, of the note and mortgage, and the land, the property, and all the right and title to the land." It will be observed, the instrument is throughout characterized as an assignment only, which does not, like the term "deed" or specialty, signify an instrument under seal. A mere written assignment, founded upon a valuable consideration, is just as available for the purpose of passing to the assignee the equitable title to land as an instrument under seal. Such being the case, we would clearly not be warranted in inferring that the assignment was under seal, from the simple fact that the witness gives it as his opinion that the instrument was "a full assignment" of the land, which is nothing more than the witness' opinion upon a question of law. There not being sufficient evidence in the record to show that the assignment was under seal, it follows that, even conceding the legal title to the property to have been in Mrs. Kearns and Greenebaum, or either of them, it could not have passed to the appellee by that instrument, and, if not by it, not at all, because that is the only muniment of title relied on for that purpose. This conclusion is of course based upon the fundamental principle that an instrument *inter partes,* in order to pass the legal title to real property, must be under seal. But this is not all. Even conceding the sufficiency of the assignment to pass the legal title, the record, in our opinion, fails to show that the assignors, or either of them, had such title; hence there was nothing for the assignment to operate upon, so far as the legal estate in the land is concerned. Having no such title, they could not convey it. *Nemo plus juris ad alium transfere potest quam ipse habet.* That the legal estate in this property was not either in Greenebaum or Mrs. Kearns at the time of the assignment to plaintiff is demonstrable by the plainest principles of law. Let us see, Thomas Kearns was the owner of this property in fee. He conveyed it in fee to Cushman. The latter, as a part of the same transaction, reconveyed it by way of mortgage to Kearns. By reason of this last conveyance, Kearns became mortgagee of the property and Cushman mortgagor. According to the English doctrine, and that of some of the states of the Union, including our own, Kearns, at least as between the parties, took the legal estate, and Cushman the equitable. According to other authorities, Kearns, by virtue of Cushman's mortgage to him, took merely a lien upon the property to secure the mortgage indebtedness, and the legal title remained in Cushman. For the purposes of the present inquiry, it is not important to consider just now, if at all, which is the better or true theory. It is manifest, and must be conceded that the legal estate in the land, after the execution of the mortgage, was either in the mortgagee or mortgagor, or in

both combined. Such being the case, it is equally clear, appellee, to succeed, must have deduced title through one or both of these parties. This could only have been done by showing that the legal title had, by means of some of the legally recognized modes of conveying real property, passed from one or both of them to himself. This he did not do, or attempt to do; indeed he does not claim through them, nor either of them. Not only so; neither Mrs. Kearns nor Greenebaum, through whom appellee does claim, derives title through any deed or conveyance executed by either the mortgagor or mortgagee; nor does either of them claim as heir or devisee of the mortgagor or mortgagee.

As the assignment of the note and mortgage to appellee did not, as we hold, transfer or otherwise affect the legal title to the land, it may be asked what effect, then, did it have? This question, like most others pertaining to the law of mortgages, admits of two answers, depending upon whether the rules and principles which prevail in courts of equity or of law are to be applied. If the latter, we would say none, because, as to the note, that could not be assigned by a separate instrument, as was done in this case, so as to pass the legal title. *Ryan v. May*, 14 Ill. 49; *Fortier v. Darst*, 31 Ill. 213; *Chickering v. Raymond*, 15 Ill. 362. As to the mortgage, it is well settled, that could not be assigned like negotiable paper, so as to pass the legal title in the instrument, or clothe the assignee with the immunity of an innocent holder, except under certain circumstances which do not apply here. *Railway Co. v. Loewenthal*, 93 Ill. 433; *Hamilton v. Lubukee*, 51 Ill. 415; *Olds v. Cummings*, 31 Ill. 188; *McIntire v. Yates*, 104 Ill. 491; *Fortier v. Darst*, 31 Ill. 213. But that the mortgagee, or any one succeeding to his title might, by deed in the form of an assignment, pass to the assignee the legal as well as the equitable interest of the mortgagee, we have no doubt, though there is some conflict on this subject. 2 Washb. *Real Prop.* p. 115, and authorities cited there. Yet the assignors, in the case in hand, not having the legal title, as we have just seen could not, by any form of instrument, transmit it to another. If, however, the rules and principles which obtain in courts of equity are to be applied, we would say that, by virtue of the assignment, the appellee became the equitable owner of the note and mortgage, and that it gave him such an interest or equity respecting the land as entitled him to have it sold in satisfaction of the debt. . . .

§302. *The Dual Nature of a Mortgage.*—This case illustrates the dual nature of a mortgage. At law it may be, as in Illinois, a conveyance; in equity it is nothing but a security for a debt

or obligation, a mere incident of a debt, the advantages of which pass from hand to hand with that debt.

§303 *BATTY v. SNOOK*

Supreme Court of Michigan, 1858. [5 *Mich.* 231.]

MANNING, J.: Once a mortgage always a mortgage, may be regarded as a maxim of the court. Equity is jealous of all contracts between mortgagor and mortgagee, by which the equity of redemption is to be shortened or cut off. The mortgagor may release the equity of redemption to the mortgagee for a good and valuable consideration, when done voluntarily, and there is no fraud, and no undue influence brought to bear upon him for that purpose by the creditor. But it cannot be done by a contemporaneous or subsequent executory contract, by which the equity of redemption is to be forfeited if the mortgage debt is not paid on the day stated in such contract, without an abandonment by the court of those equitable principles it has ever acted on in relieving against penalties and forfeitures. What we now call a mortgage was at common law a conditional conveyance of the land, by which the title of the vendee was to terminate or become absolute on the performance or non-performance of the condition of the grant by the vendor at the day. When such conveyance was made to secure a debt, or for the performance of some other act by the vendor, equity took cognizance of the transaction, and declared the conveyance a security merely for the payment of the debt, or doing of the act, and on the performance thereof by the vendor, after the day had elapsed, and the estate had become absolute, would decree a reconveyance of the premises. To allow the equity of redemption to be cut off by a forfeiture of it in a separate contract, would be a revival of the common law doctrine, using for that purpose two instruments, instead of one, to affect the object. . . .

The decree of the court below, dismissing the complainant's bill with costs, must be reversed, and a decree be entered declaring the deed and contract one transaction, and to be a mortgage, and that complainant is entitled to redeem; and the transcript must be remitted to the court below for further proceedings.[1]

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[1]Although no agreement of forfeiture for non-payment on time between mortgagor and mortgagee will be enforced, if the parties to a contract to sell land make such an agreement upon the distinct understanding that time shall be of the essence, most states will enforce it. By the weight of authority the buyer in default under such an agreement may not recover the installments which he has paid, although a majority of cases hold that he may have specific performance of the contract by paying with interest what remains due on the price.

§304 *CORNING v. BURTON.*

Supreme Court, Michigan, 1894. [102 *Mich.* 86.]

HOOKER, J.: On May 8, 1886, Burton and Ellsworth executed and delivered to Corning a promissory note for $3,200, and secured it by a mortgage upon real estate. In October, 1887, Burton deeded an undivided half of the premises to Dickerson, the deed stating that it was subject to a mortgage of $3,200 and accrued interest thereon, "one-half of which encumbrance and debt said second party [*i.e.,* Dickerson] assumes and agrees to pay." On November 10, 1887, Ellsworth deeded to Dickerson the other undivided half of the land, by a deed containing similar provisions. On July 25, 1888, said Dickerson conveyed the premises to McQueen, a similar provision in the deed requiring him to pay the mortgage mentioned. Subsequently the executors of Corning filed the bill in this cause, and obtained a decree of foreclosure and sale upon bill taken as confessed for want of appearance, under which the premises were sold by the commissioner, and the usual proceedings followed. Burton, Ellsworth, Dickerson, and McQueen were made defendants by the bill. Under a petition for execution against them for a deficiency, Dickerson and McQueen answered, and were heard by counsel. From a denial of the prayer of this petition, complainants appeal. . . .

We consider it unnecessary to discuss at length the proposition that a personal decree may be rendered in a foreclosure case against a grantee of the mortgagor, who has accepted a deed stating that it is subject to the mortgage, which the grantee assumes and agrees to pay. It is settled by repeated decisions in this state and in New York, from which state we borrowed the statute (2 How. Ann. Stat. §6704) which authorizes it. Such decisions will be found collected in the note to section 6702. Just such a decree was rendered in this case by a court having full jurisdiction of the subject-matter and the parties, from which decree defendants did not choose to appeal.

But, if that decree should be thought not conclusive, we have no doubt of the defendant Dickerson's liability upon this record. It is claimed that by his deed to McQueen upon his undertaking to pay he was released from liability. But we think otherwise. When Dickerson bought the premises, a part of the consideration was his promise to pay this mortgage. His grantors had, and still have, a right to require him to perform that promise, just as much as the mortgagee has the right to say that the mortgagors are still indebted to him, notwithstanding their sale of the land upon the promise that another would pay the debt.

The sale to McQueen does not deprive any one not a party to it of rights then existing against Dickerson. Doubtless equity would say that McQueen was primarily liable, Dickerson next, and the mortgagors last; but all are liable. To hold otherwise would be to say that Dickerson could escape his personal liability, and compel the mortgagor to pay, by deeding to an impecunious person who should assume the debt.

The decree of the Circuit Court will be reversed, and one entered here in accordance with the prayer of the petition, with costs of both courts.

The other justices concurred.

§305. *The Passing of the Burden with the Property.*—When mortgaged property is conveyed by the mortgagor, the property of course remains subject to the mortgage. And the mortgagor, too, remains personally liable for the debt, and for any deficiency if the mortgaged property does not bring enough money at a sale to pay the debt. On the question of personal liability on the part of the purchaser, a distinction must be made between a purchase which is simply subject to the mortgage and one in which the purchaser assumes and agrees to pay the debt. In the former case there is no personal liability on the part of the purchaser; in the latter case, there is such personal liability according to the overwhelming weight of American authority, especially when the vendor was under personal liability to pay the mortgage.

A more difficult question is raised when a part of the mortgaged premises is sold. Does that part carry a portion of the burden equally with the rest, or is there a presumption that the retained portion must exonerate the portion sold?

§306 *NORWOOD v. DE HART.*

Court of Chancery, New Jersey, 1879. [30 *N. J. Eq.* 412.]

THE CHANCELLOR: This suit is brought to obtain a decree against the defendants for the amount remaining unpaid upon a decree in favor of the complainants in a suit for foreclosure of mortgage upon premises which were owned by the defendants respectively, at different times, subject to the mortgage. The mortgaged premises were sold under the execution issued on the decree in that suit, and were purchased by the

holder of a mortgage prior to that of the complainants, for a sum less than the amount due on his mortgage, so that nothing was realized by the complainants on their mortgage.

The bill states that the complainants' mortgage, which is for $2,000 and interest, was given by Charles Meyenberg, on or about the 20th of July, 1869, that the prior mortgage, which was for $2,000 and interest, was given in 1868, by Frank Hunkley; that in May, 1871, one Nicholas Pflaum, then being the owner of the mortgaged premises, and both of the mortgages being subsisting liens thereon for the full amount of the principal thereof, conveyed the property to De Hart, for the consideration of $10,000, as stated in the deed; that the deed contained the declaration and acknowledgment that the conveyance was made subject to the mortgages, and that the principal thereof was computed as part of the purchase-money, and contained also the stipulation that the existence of the mortgages should not be held to work a breach of any of the covenants in the deed; that in August, 1871, De Hart conveyed the premises to Benjamin Sire expressly subject to those mortgages and a subsequent one for $1,000 and interest, which had been given thereon by De Hart; that the deed to Sire contained the declaration that the principal of those mortgages was computed as so much of the purchase-money of the property; that in September, 1871, Sire conveyed the property to Moses H. Williams, expressly subject to the three mortgages, and Williams therein assumed the payment of them; that Williams afterwards died, and the executors of his will, in March, 1873, conveyed their right, title, and interest in and to the property, to De Hart, subject to the three mortgages, the payment of which he thereby assumed; that subsequently, in December, 1873, De Hart sold and conveyed all his interest in the premises to the defendant Genung, subject, as stated in the deed, to the encumbrance of two mortgages, the principal of which amounted to $4,000, the payment of which Genung thereby expressly assumed; and that, in January, 1872, the complainants' testator began the above mentioned suit for foreclosure, which resulted as before stated.

The complainants' claim to a decree against the defendants rests on the ground that the creditor is entitled to the benefit of all the collateral securities which the debtor has obtained to re-enforce the primary obligation. *Klapworth v. Dressler*, 2 Beas. 62. But a mortgagee cannot avail himself of an assumption to pay his mortgage contained in a deed to a subsequent purchaser, unless the grantor was himself personally liable to pay the debt. *Crowell v. Hospital of St. Barnabas*, 12 C. E. Gr. 650, 656; *King v. Whitely*, 10 Paige, 465; *Trotter v. Hughes*,

12 N. Y. 74. In this case, it does not appear, from the bill, that De Hart's grantor, Pflaum, was personally liable for the payment of the complainants' mortgage. It, therefore, does not appear (giving to the acknowledgment contained in the conveyance from Pflaum to De Hart, that the mortgage debt was allowed as part of the consideration of the conveyance, all the effect which, under the decision of this court in *Tichenor v. Dodd*, 3 Gr. Ch. 454, it would have as between grantor and grantee) that there has ever existed any obligation, on the part of De Hart, to indemnify Pflaum against the complainants' mortgage debt. And this consideration is equally fatal to the claim made under the assumption contained in the deed from the executors of Williams, for it does not appear that they were liable to indemnify their grantor. Each grantee who assumed the payment of the mortgages was bound thereby only to indemnify, and if no liability to pay the mortgage debt existed on the part of his immediate grantor, there is no ground for claim of indemnity on the part of the grantor, and, consequently, no personal liability on the part of the grantee to pay the mortgage debt.

The fact that it does not appear that Pflaum was personally liable to pay the mortgage debt, is fatal to the claim of the complainants against the demurrant.

The demurrer will be sustained, with costs.

§307 *NATIONAL SAVINGS BANK v. CRESWELL.*

United States Supreme Court, 1880. [100 *U. S.* 630.]

MILLER, J., delivered the opinion of the court:

Samuel P. Brown, being seized in fee of a large number of lots constituting the subdivision of a tract of land into the Town of Mount Pleasant, had a judgment rendered against him, March 3, 1870, in favor of one Jolly, for the sum of $4,694.05, in the Supreme Court of the District of Columbia, and the lots being within the District, the judgment became from that day a lien on them. On the 20th day of June of that year, Mr. Brown borrowed of the Freedman's Savings and Trust Company the sum of $10,000 and executed to Daniel L. Eaton a deed of trust conveying a part of the lots owned by him in Mount Pleasant, as security for the repayment of the loan. Under this deed of trust the lots were sold and bought in for the Freedman's Bank, and they have resold several of them and guaranteed the title to the purchasers.

A few months after the execution of the deed of trust above mentioned by Brown, he began to borrow money from the Na-

tional Savings Bank, the appellant in this case, and gave deeds of trust on other lots in the same subdivision to secure the payment of these loans. In July, 1874, the National Savings Bank, fearing the loss of their security by the judgment against Brown of March 3, 1870, purchased that judgment, and ordered an execution to be issued on it, which was levied on the lots conveyed to Eaton for the benefit of the Freedman's Bank. That bank having passed into the control of Creswell and others, as commissioners appointed to wind up its affairs, they brought the present bill in chancery to release those lots from sale under that execution. . . .

The appellants argue that the subjection of the property covered by the lien of the judgment to its satisfaction, in the inverse order of its alienation, is not the prevailing rule in courts of equity, nor the rule of property in the District of Columbia. . . .

The older cases cited for this proposition scarcely sustain it. In *Sir William Harbert's Case,* reported 3 Coke, 11, it was resolved that "If A be seised of three acres, and acknowledge a recognizance or statute, and enfeoff B of one acre and C of another acre, and the third descends to his heir, and if execution be sued out against the heir he shall not have contribution against the purchasers, for the heir sits in the seat of his ancestor." Among them is, also, the case of *Lanoy v. Duke of Athol,* 2 Atk. 444, in which Lord Hardwicke says: "Suppose a person who has two real estates, mortgages both to one person, and afterwards only one estate to a second mortgagee, who had no notice of the first; the court, in order to relieve the second mortgagee, have directed the first to take his satisfaction out of that estate only which is not in mortgage to the second mortgagee, if that is sufficient to satisfy the first mortgage, in order to make room for the second mortgagee, even though the estates descended to two different persons." This seems to be a pretty clear statement of the rule adopted in many of the states of the Union at the present day, though based rather upon the principle applicable to marshalling assets, that he who has a right to resort to two funds, in one of which alone another party has a subsidiary lien, shall be compelled to exhaust the one to which the other cannot resort before coming upon the one in which they both have an interest, than on the ground now relied on in the courts of this country.

That ground is, that the first purchaser has a right to suppose that the part of the mortgaged property which he leaves with the mortgagor, will, in his hands, be first subjected to the payment of the mortgage he has made. To this Judge Story assents. But the principle goes further, and holds that when

a second purchaser from the mortgagor buys either all or a part of the incumbered property which remains, he cannot place himself in a better position than his grantor, and revive the burden on the first purchaser's land, from which it had been wholly or partially relieved by its primary pressure on the land left by him in the hands of the mortgagor. . . .

That principle was stated by Chancellor Kent, with his usual force and clearness, in 1821, in the case of *Clowes v. Dickenson,* which has become the leading case on the subject in this country. 5 Johns. Ch., 235.

After referring to the case of Sir William Harbert, he says: "This case settles the question as between the vendor and purchaser, or the heirs of the vendor and purchaser, and if there be several purchasers in succession at different times, I apprehend in that case, also, there is no equality and no contribution as between these purchasers. Thus, for instance, if there be a judgment against a person owning at the time three acres of land, and he sells one acre to A, the two remaining acres are first chargeable in equity with the payment of the judgment debt, as we have already seen, whether the land be in the hands of the debtor himself or of his heirs. If he sells another acre to B, the remaining acre is then chargeable in the first instance with the debt as against B, as well as against A; and if it should prove insufficient, then the acre sold to B ought to supply the deficiency in preference to the acre sold to A; because, when B purchased, he took his land chargeable with the debt in the hands of the debtor, in preference to the land already sold to A. In this respect we may say of him as it is said of the heir, he sits in the seat of his grantor, and must take it with all its equitable burdens; it cannot be in the power of the debtor, by the act of assigning or selling his remaining land, to throw the burden of the judgment or a ratable part of it back upon A." The doctrine and the reason upon which it is founded cannot be better stated than in this extract from the opinion.

We may, as an additional reason, suggest a principle often called into action in recent times in the courts, namely: that where one of two innocent persons must suffer a loss, it should fall on him who by reasonable diligence and care, could have protected himself, rather than on him who could not. In the case supposed, the second purchaser, at the time of his purchase, knowing that the land which he buys is subject to the incumbrance before that already sold, can exact of the vendor security or protection against the encumbrance, which it is out of the power of the first vendor to do at the time his risk is increased by the very act of the second purchaser. . . .

Decree affirmed.

§308 *WING v. McDOWELL.*

Court of Chancery of Michigan, 1843. [*Walker Ch.* 175.]

THE CHANCELLOR: The rights of the parties are the same now as before the agreement was entered into between McDowell and Lawrence, to cancel the Tuthill mortgage, and give one running directly to Lawrence, in its place. All parties had notice of the $3,000 mortgage to Simmons, before the change was made; and what has taken place since cannot effect his rights.

It is said McDowell might have sold, or mortgaged, his contract, but that he had no interest in the land itself, to mortgage, the title being in Lawrence. At law, a contract for the purchase of land gives the vendee no interest in the land; but the rule is otherwise in equity, which considers the vendor, as to the land, a trustee for the purchaser, and the vendee, as to the money, a trustee for the seller. In equity, the land belongs to the vendee, and may be sold, devised, or encumbered by him, and, on his death, will descend to his heirs. *Seton v. Slade,* 7 Ves. R. 265, 274; 6 Ves. R. 353; *Champion v. Brown,* 6 J. C. R. 398. It must be taken, however, subject to the rights of the vendor under the contract. And, McDowell having an equitable interest in the land under the contract, the mortgage from him to Simmons was an equitable mortgage of that equitable interest.

This mortgage was recorded on the day it was executed, and it is insisted that the registry of it was notice, to both Tuthill and Lawrence, in their subsequent dealings with McDowell, and with each other. The registry of a deed or conveyance required by law to be recorded, when properly registered, is notice to subsequent purchasers of the existence and contents of such deed or conveyance, in equity, as well as at law. If an instrument should be registered, which the law does not require to be registered, the record of it would be notice to no one; for no person is expected, much less bound, to examine the registry for that which has no business to be there. Our registry law, it seems to me, has reference to conveyances of the legal estate, or interest in law, only, except where a trust is created, or declared, in writing, which, to be notice to subsequent purchasers, the statute requires to be recorded. The language of the statute is: "No bargain and sale, or other like conveyance of any estate in fee simple, or for life, and no lease for more than seven years from the making thereof, shall be valid and effectual against any other person than the grantor, and his heirs and devises, and persons having actual notice

thereof, unless it is made by a deed recorded as provided in this chapter." R. S. 260. In *Parkist v. Alexander,* 1 J. C. R. 397, Chancellor Kent thought the better opinion was, that the registry of an equitable mortgage was notice to a subsequent purchaser of the legal estate. His opinion in that case, however, was based on the peculiar phraseology of the registry act itself. He says: "The statute I have cited speaks of any 'writing in the nature of a mortgage,' and these words may reach to any agreement creating an equitable encumbrance." The language of our statute is not so broad, and the case of *Parkist v. Alexander,* consequently, is no authority that the registry of a mere equitable mortgage, like the one to Simmons, is, under our statute, notice to subsequent purchasers.

The mortgage to Tuthill stood on the same footing with that to Simmons, with this difference, that Simmon's mortgage was prior in time. They were both liens on McDowell's equitable interest in the land, and neither of them was an assignment of the bond for a deed by way of mortgage. Neither Simmons nor Tuthill acquired any legal interest in the bond; neither could have sued Lawrence for a breach of its condition; their interest was purely equitable, not legal, and their remedy against Lawrence, as well as McDowell, such as could be had in a court of equity only. What then were the relative rights of Simmons and Tuthill, under their respective mortgages? The rule in equity on this point is well expressed by Chancellor Walworth, in *Grimstone v. Carter,* 3 Paige R. 436. He says: "It is the settled doctrine of the court that, when the equities of the parties are equal, and neither has the legal title, the one who has the prior equity must prevail. Nor will the court permit the party having the subsequent equity to protect himself by obtaining a conveyance of the legal title, after he has either actual or constructive notice of the prior equity." As between these two mortgages, then, Simmons's mortgage, being prior in time, was prior in right; and this priority was not destroyed, or lost, by the assignment of the Tuthill mortgage to Lawrence without notice of the prior mortgage. Tuthill had no notice of the mortgage to Simmons when he took his mortgage; and an assignment of it to a third person without notice could not give the assignee a better right than Tuthill himself had. Lawrence acquired the right of Tuthill, and nothing more. There was not a union of the legal estate and a subsequent equity *in the same right,* for Lawrence held the legal title *in trust* for McDowell; and, before the agreement was consummated to cancel the Tuthill mortgage and give another in its place, when he acquired the legal estate in his own right, both he and Wing-

had notice of the Simmons mortgage. The English doctrine of tacking, which perhaps, would be applicable to such a case, has not been adopted in this country. 1 Caines Ca. 112; 3 Pick. R. 50; 1 Hopk. R. 234; 4 Kent *Com.* 178, 179.

The premises included in Simmons's mortgage must be sold separately, and, out of the proceeds thereof, the $250 note given by McDowell to Lawrence for the purchase-money must first be paid (the other note having been paid), and then Simmons's mortgage for $3,000; and, with the balance, if any, and the proceeds of the residue of the mortgaged premises, the Lawrence mortgage must then be paid and then Simmons's second mortgage.

§309. *The Balancing of Equities.*—In this case, the prior equity of one of the mortgagees was allowed to prevail in spite of two contentions: 1, that registration gives priority; 2, that where equities are equal, the law (that is, the holding of the legal title) prevails. Ordinarily the first of these contentions would be conclusive in America and the second in England and some of the older American jurisdictions. Why did they not prevail in this case?

D. Pledges.

§310 *CHRISTIAN v. ATLANTIC & N. C. RAILROAD.*

United States Supreme Court, 1890. [133 *U. S.* 233.]

BRADLEY, J.: . . . The ground on which it is contended that this may be done [that is, proceed without the consent of the state where the state is the real adverse party] is: that the property is affected by a pledge, and may, therefore, be dealt with *in rem.* But a pledge, in the legal sense, requires to be delivered to the pledgee. He must have the possession of it. He may then, in default of payment of debt for which the thing is pledged, sell it for the purpose of raising the amount, by merely giving proper notice to the pledgor. In the case of stocks and other choses in action, the pledgee must have possession of the certificate or other documentary title, with a transfer executed to himself, or in blank (unless payable to bearer), so as to give him the control and power of disposal of it. Such things are then called pledges, but more generally collaterals; and they may be used in the same manner as pledges properly so called. If there is no

transfer attached to, or accompanying the document, it is imperfect as a pledge, and requires a resort to a court of equity to give it effect.

These propositions are so elementary that they hardly need a citation of authorities to support them. Reference may be made, however, to Story on *Bailment,* §297, *et seq.; Casey v. Cavaroc,* 96 U. S. 467.

The stock and dividends of the State of North Carolina, now in question, have nothing about them in the nature of a pledge. The 10th section of the act of 1855, relied on by the complainant for creating a pledge, must be understood as using the word in a popular and not in a technical sense. That section declares: first, that as security for the redemption of said certificates of debt the public faith of the state is hereby pledged to the holders thereof. This is no more than a solemn promise on the part of the state, to redeem the certificates. The section next, in addition to the pledge of the public faith, declares that all the stock held by the state in the Atlantic and North Carolina Railroad Company shall be pledged for the same purpose, and any dividend of profit declared thereon shall be applied to the payment of the interest on said bonds. This was nothing more than a promise that the stock should be held and set apart for the payment of the bonds, and that the dividends should be applied to the interest. There was no actual pledge. It was no more of a pledge than is made by a farmer when he pledges his growing crop, or his stock of cattle, for the payment of a debt, without any delivery thereof. He does not use the word in its technical, but in its popular sense. His language may amount to a parol mortgage, if such a mortgage can be created; but that is all. So in this case, the pledge given by the state in a statute may have amounted to a mortgage, but it could amount to nothing more; and if a mortgage, it did not place the mortgagee in possession, but gave him merely a naked right to have the property appropriated and applied to the payment of his debt. But how is that right to be asserted? If the mortgagor be a private person, the mortgagee may cite him into court and have a decree for the foreclosure and sale of the property. The mortgagor, or his assignee, would be a necessary party in such a proceeding. Even when absent, beyond the reach of process, he must still be made a party and at least constructively cited by publication or otherwise. This is established by the authorities before referred to, and many more might be cited to the same effect. The proceeding is a suit against the party to obtain, by decree of court, the benefit of the mortgage right. But where the mortgagor in possession is a sovereign

state, no such proceeding can be maintained. The mortgagee's right against the state may be just as good and valid, in a moral point of view, as if it were against an individual. But the state cannot be brought into court or sued by a private party without its consent. It was at first held by this court that, under the Constitution of the United States, a state might be sued in it by a citizen of another state, or of a foreign state; but it was declared by the 11th amendment that the judicial power of the United States shall not be construed to extend to such suits. *New Hampshire v. Louisiana,* 108 U. S. 76; *Louisiana v. Jumel,* 107 U. S. 711; *Marye v. Parsons,* 114 U. S. 325; *Hagood v. Southern,* 117 U. S. 52; *In re Ayers,* 123 U. S. 443.

§311. *The Pledge and the Mortgage Distinguished.*—While the pledge resembles the mortgage outwardly in that it is a means of securing credit by giving the creditor control over one's property, the pledge has an entirely distinct history from the mortgage. It is based on the transfer of possession, coupled with certain powers, and not at all on the transfer of title.

§312. *From William H. Loyd. The Surety.* 66 *U. of Pa. L. Rev.* 40.—"Collateral security that is a secondary obligation annexed to a contract to guarantee its performance, or the pledging of property to insure the performance of a principal engagement, or to furnish means of indemnity in case of non-performance, is an idea familiar to modern law and was fairly developed in the legal systems of some of the civilized nations of antiquity. But, speaking relatively, it is recent; that is, it is an idea that belongs to the later growth of any system of law in which it appears. For among primitive peoples there is no credit and each transaction must be final, in form at least. Difficulties would occur chiefly in executing the judgment of the group assembled as a court. The wrongdoer must pay, but present satisfaction is all that the injured person is obliged to take. The delinquent may then do one of three things. He may hand over property in settlement of the liability, perhaps with the privilege of redemption, the forerunner of the modern pledge and mortgage. He may surrender himself and work out the debt in *quasi* servitude. Or, he may surrender to the creditor, a relative or friend, as a provisional satisfaction while he proceeds to acquire

the sum directed to be paid, the predecessor of the modern surety or guarantor.[1] Indeed, the surety was in the beginning no more than an animated gage or hostage, as that term is still understood in international law,[2] delivered over to imprisonment, perhaps servitude, but subject to redemption. He frees the debtor taking his place just as a *res* would.''[3]

§313. *GOLDSMIDT v. FIRST METHODIST CHURCH.*

Supreme Court of Minnesota, 1878. [25 *Minn.* 202.]

GILFILLAN, C. J.: . . . The first question in the case is, had Bartlett [the pledgee] the right to sell at private sale, and without any notice to Miller [the pledgor] of the time and place of the sale?

The pledge of personal property, to secure a debt, generally vests in the pledgee the power to make the money by a sale of the property, without a decree of court. It has been affirmed that this power to sell does not attach to a pledge of negotiable paper. *Wheeler v. Newbould*, 16 N. Y. 392. It is not necessary to decide the point in this case, for, by the agreement between the pledgor and pledgee, the latter was authorized to make the money out of the notes pledged, in the best way be could, and sell the same for that purpose. So that, so far as the power to sell was concerned, the pledge was put upon the same footing as though the law had, as in the case of a pledge of other property, attached such power to sell. In case of a debt pledged, the pledgee may receive payment of the debt, and may sue for and collect it. *White v. Phelps*, 14 Minn. 27. To receive payment, to sue for and collect, and to sell, are the only ways in which the money can be made out of pledged negotiable paper; and the agreement between the pledgor and the pledgee in this instance authorized the pledgee to resort to either of them, and he resorted to the latter. It was competent for the parties to agree how the sale should be made; but without any such agreement, and where the power to sell is merely given, the power will be construed to be such a power as exists in respect to pledges generally, and must be exercised in the same way. In respect to pledges generally, the power can be

[1]*The Pledge-Idea* by J. H. Wigmore, 10 Harv. L. Rev. 43 (1897).

[2]Prof. Hershey says the last treaty secured by hostages was that of Aix la Chapelle, 1745. Hershey's *International Law*, 319. In the [recent war] civilians [were] constantly held as hostages for the good conduct of their neighbors.

[3]*The Pledge Idea, supra;* Kohler's *Philosophy of Law* (Amer. Ed.) 158; 2 Pollock & Maitland, *Hist.* 184.

exercised only upon reasonable notice to the debtor to redeem, and of the time and place of sale. *Wheeler v. Newbould,* 16 N. Y. 392; *White v. Phelps,* 14 Minn. 27; *Stearns v. Marsh,* 4 Denio, 227; *Cortelyou v. Lansing,* 2 Caines Cas. 200. This notice is essential to secure fairness in the transaction, and to enable the pledgor to protect his interests.

The notice in this case was only of an intention to sell, without specifying time or place, and was similar to that in *Wheeler v. Newbould,* concerning which the court said: "If the creditor does no more than give the notice of his intention to sell, without saying when or where, or in what manner, he deprives the debtor of a substantial right which the notice is designed to secure." It was insufficient, and did not justify the sale. The court below was of that opinion, but held that the notes having been endorsed in blank by the payee Miller, the purchasers from Bartlett, whether the trustees or the corporation, came within the protection accorded to *bona fide* endorsees of negotiable paper. This would be so, were it not for the fact that the purchasing trustees, at the time of the purchase, knew that Bartlett held the notes as a pledge to secure the debt from Miller, knew, in effect, that his interests, and rights, and power over the notes were not those of an ordinary endorsee in the usual course of business, but those of a pledgee, and that his power to sell depended on his having given the proper notice. Having this notice, the blank endorsement cannot protect them in purchasing at a sale which the holder of the notes had no right to make. Notwithstanding such sale, the notes are still the property of the plaintiff.

Order reversed, and new trial ordered.

§314. *Power to Effectuate Pledges Distinguished from Title.*—A pledge is unlike an ordinary possessory lien in that it carries with it a power of sale. This power, however, is quite a different concept from title and must be exercised only under such technical safeguards as are described in this case for the protection of the interest of the title holder. For an illustration of how far ordinary rules are commonly suspended by agreement of the parties, examine the blank form of collateral note in use by your bank.

Statutory restrictions are provided in the case of pawnbrokers, with reference to notice, publicity, records and the like, partly to prevent them from receiving stolen goods, but partly, too, for the protection of borrowers against harsh measures.

§315. *FORBES v. BOSTON & LOWELL RAILROAD.*

Supreme Court of Massachusetts, 1882. [133 *Mass.* 154.]

MORTON, C. J.: The first case is an action of tort, containing a count for the conversion of a quantity of corn and a count for the conversion of a quantity of wheat. As different considerations apply to the two counts, they must by treated separately.

On or about October 20, 1879, Gallup, Clark and Company, grain-dealers in Chicago, in response to an order from Foster and Company, forwarded to Boston fifty carloads of corn, by the National Dispatch Fast Freight Line, which is an association of several railroad companies, whose roads make a continuous line from Chicago to Boston, the defendant's road being a part of the line. Upon the shipping of the corn, an inland bill of lading was issued, by which it was consigned to the order of Gallup, Clark and Company, at Boston. Gallup, Clark and Company drew a draft upon Foster and Company for the price of the corn, attached to it the bill of lading, and forwarded both to the Tremont National Bank of Boston. On October 24, 1879, Foster Company paid to the bank the amount of the draft, and the draft and bill of lading were delivered to them. Immediately upon obtaining the draft and bill of lading, Foster and Company indorsed them to the plaintiffs, as security for an advance then made by the plaintiffs to the full amount of the draft, and they have held them ever since. The corn mentioned in the bill of lading was received and transported by the defendant, arriving in Boston on October 30, 1879. It remained in its cars until December 12, 1879, when by the orders of Foster and Company it was shipped on board a vessel for Cork, and exported to Ireland. Foster and Company did not produce and present to the defendant the bill of lading, but represented that it was in their possession.

Upon these facts, it is too clear to admit of any doubt, that, by the transfer of the draft and bill of lading by Foster and Company to the plaintiffs, the title and property in the corn passed to them. The bill of lading, though not strictly a negotiable instrument like a bill of exchange, was the representative of the property itself; it was the means by which the property was put under the power and control of the plaintiffs, and the delivery of it was for most purposes equivalent to an actual delivery of the property itself.

The transaction between Foster and Company and the plaintiffs was not in form or in effect a mortgage, so that, as contended by the defendant, it must be recorded in order to have

validity; it was a transfer and delivery of the property. The clear intent of the parties was that the property in the corn should pass to the plaintiffs as security for the advance made by them. Whether they took an absolute title with a liability to account for the proceeds, or a title as pledgees, is not material, as all the authorities show that they took either a general or a special property in the corn, which entitles them to recover of any one who wrongfully converts it. *De Wolf v. Gardner,* 12 Cush. 19. *Cairo National Bank v. Crocker,* 111 Mass. 163. *Chicago National Bank v. Bayley,* 115 Mass. 228. *Green Bay National Bank v. Dearborn,* 115 Mass. 219. *Hathaway v. Haynes,* 124 Mass. 311. *Gibson v. Stevens,* 8 How. 384. *Dows v. National Exchange Bank,* 91 U. S. 618. Numerous other cases might be cited. The delivery of the bill of lading was in law the delivery of the property itself, and it was not necessary that the plaintiffs should take immediate possession of it upon its arrival, or that they should give notice to the carrier or warehouseman who held the property. *Farmers & Mechanics' National Bank v. Logan,* 74 N. Y. 568. *The Thames,* 14 Wall. 98. *Meyerstein v. Barber,* L. R. 2 C. P. 38, 661, and L. R. 4 H. L. 317. It is true that the plaintiffs might by their subsequent laches defeat their right to assert their title. If they permitted the property to remain under the control of their assignors, and held them out to the world as having the right to deal with the property, they might be estopped from setting up their title. But the authorities are decisive to the point that, by the transfer from Foster and Company, they took a title as purchasers of the corn which entitles them to maintain this action, unless they have lost the right by their laches, upon proving a conversion by the defendant.

The next question is whether there was a conversion by the defendant. It is settled that any mis-delivery of property by a carrier or warehousemen to a person unauthorized by the owner or person to whom the carrier or warehouseman is bound by his contract to deliver it, is of itself a conversion, which renders the bailee liable in an action of tort in the nature of trover, without regard to the question of his due care or negligence. *Hall v. Boston & Worcester Railroad,* 14 Allen, 439. By the bill of lading, and by the way-bill which was sent to the defendant in the place of a duplicate bill of lading, the corn was to be delivered to the order of Gallup, Clark and Company. The defendant contracted to deliver it to such person as Gallup, Clark and Company should order, and could not without violating its contract deliver it to any other person. By delivering

it to Foster and Company, therefore, the defendant became liable for a conversion, unless it shows some valid excuse. *Newcomb v. Boston & Lowell Railroad,* 115 Mass. 230. *Alderman v. Eastern Railroad,* 115 Mass. 233. The record before us does not show any laches or any act of the plantiffs which can excuse or justify this mis-delivery. They did not hold Foster and Company out to the world or the defendant as one entitled to control the property. Indeed, it is admitted that the defendant did not know, until long after the delivery, that the plaintiffs had any connection with the property, or with Foster and Company. The plaintiffs did nothing to mislead the defendant. They had the right to rely upon the facts that they held the bill of lading, and that, according to the ordinary course of business, the goods could not be obtained except upon its production. The defendant saw fit to deliver them to Foster and Company without requiring them to produce the bill of lading, relying upon their representation that they were the holders of it. It took the risk of their truthfulness, and cannot now shift that risk upon the plaintiffs, who have done nothing to mislead or deceive the defendant. We are, for these reasons, of opinion that the defendant is liable for the value of the corn described in the first count of the declaration.

In the case of the wheat, there are some facts proved at the trial which lead us to a different result. By the bills of lading and the way-bills, the wheat was consigned to John H. Foster and Company at Boston. The fact that they did not contain the words "or order," or other equivalent words, so as to make them upon the face quasi negotiable, is not important. The bill of lading was yet the representative of the wheat, and its transfer and delivery to the plaintiffs vested in them the title to the property, as against the consignees and their creditors. But the presiding justice of the Superior Court who heard the case has found as a fact, "that it was the custom of the railroads terminating in Boston to deliver to the consignee goods 'billed straight' as it is termed, that is, billed to a particular person, not to order, when they were satisfied of the identity of the consignee, without requiring the production of the bills of lading, and to rely upon the way-bills to determine the consignee and the form of the consignment."

Under the finding, we must assume that the custom existed, and that the plaintiffs knew or ought to have known of it, It materially affects the relations and rights of the parties. Although it does not affect the question of the title of the plaintiffs as against Foster and Company, it qualifies the duties of

the defendant as to the delivery of the wheat. It justified the defendant in delivering it to Foster and Company, the consignees, at least at any time before notice that the property had been transferred. Under it, there was no laches in not calling for the bill of lading; and, in thus delivering, there was no violation of any of the terms of its contract, express or implied. Such delivery therefore was not a mis-delivery which would amount to a conversion and render the defendant liable to the plaintiffs. We are therefore of opinion that the defendant is not liable for the value of the wheat sued for. . . .

§316. *Bills of Lading as Documents of Title and Means of Pledging.*—The bill of lading has become a most important kind of collateral security. Observe that a pledge by means of handing over possession of a symbol instead of the actual goods can be accomplished by means of a "straight" bill of lading as well as by means of a bill of lading drawn to order or bearer, although as is illustrated in this case, the form of the bill of lading may make a difference in the carrier's liability when he surrenders goods without calling for the surrender of the bill of lading.

By the custom of merchants the delivery of an indorsed "negotiable" document of title is regarded as having superior validity over a delivery of the goods themselves. One entrusted with mere possession of goods is not thereby empowered to sell, mortgage, or pledge them, but the mercantile idea is that one entrusted with an indorsed "negotiable" document of title is empowered to transfer a good title. The mercantile theory is recognized in the Uniform Bills of Lading Act, §38, and also in the Uniform Sales Act, §38, which reads as follows: "The validity of the negotiation of a negotiable document of title is not impaired by the fact that the negotiation was a breach of duty on the part of the person making the negotiation, or by the fact that the owner of the document was induced by fraud, mistake or duress to entrust the possession or custody thereof to such person, if the person to whom the document was negotiated or a person to whom the document was subsequently negotiated paid value therefor, without notice of the breach of duty, or fraud, mistake or duress."

E. Negotiable Instruments.

§317 *GOODWIN v. ROBARTS.*

Exchequer Chamber, 1875. [L. R. 10 *Exchequer* 337.]

COCKBURN, C. J.: . . . Bills of exchange are known to be of comparatively modern origin, having been first brought into use, so far as it is at present known, by the Florentines in the twelfth, and by the Venetians about the thirteenth century. The use of them gradually found its way into France, and, still later, and but slowly, into England. We find it stated in a law tract by Mr. Macleod, entitled "*Specimen of a Digest of the Law of Bills of Exchange,*" printed, we believe, as a report to the government, but which from its research and ability, deserves to be produced in a form calculated to insure a wider circulation, that [Gerard Malynes], a London merchant, who published a work called the "*Lex Mercatoria,*" in 1622, and who gives a full account of these bills as used by the merchants of Amsterdam, Hamburg, and other places, expressly states that such bills were not used in England. There is reason to think, however, that this is a mistake. Mr. Macleod shows that promissory notes, payable to bearer, or to a man and his assigns, were known in the time of Edward IV. Indeed, as early as the statute of 3 Rich. II., ch. 3, bills of exchange are referred to as a means of conveying money out of the realm, though not as a process in use among English merchants. But the fact that a London merchant, writing expressly on the law merchant, was unaware of the use of the bills of exchange in this country, shows that that use at the time he wrote must have been limited. According to Professor Story, who herein is, no doubt, perfectly right, "the introduction and use of bills of exchange in England," as indeed it was everywhere else, "seems to have been founded on the mere practice of merchants, and gradually to have acquired the force of a custom." With the development of English commerce the use of these most convenient instruments of commercial traffic would, of course, increase; yet, according to Mr. Chitty, the earliest case on the subject to be found in the English books is that of *Martin v. Boure,* 2 Cro. Jac. 6, in the first James I. Up to this time the practice of making these bills negotiable by indorsement had been unknown, and the earlier bills are found to be made payable to a man and his assigns, though in some instances to bearer.

But about this period—that is to say, at the close of the sixteenth or the commencement of the seventeenth century—the

practice of making bills payable to order, and transferring them by indorsement, took its rise. Hartmann, in a very learned work on bills of exchange recently published in Germany, states that the first known mention of the indorsement of these instruments occurs in the Neapolitan Pragmatica of 1607. Savary, cited by Mons. Nouguier, in his work, "*Des Lettres de Change*," had assigned to it a later date, namely, 1620. From its obvious convenience this practice speedily came into general use, and, as part of the general custom of merchants, received the sanction of our courts. At first the use of bills of exchange seemed to have been confined to foreign bills between English and foreign merchants. It was afterwards extended to domestic bills between traders, and finally to bills of all persons, whether traders or not. Chitty, *Bills* (8th ed.), p. 13.

In the meantime, promissory notes had also come into use, differing herein from bills of exchange: That they were not drawn upon a third party, but contained a simple promise to pay by the maker, resting, therefore, upon the security of the maker alone. They were at first made payable to the bearer, but when the practice of making bills of exchange payable to order, and making them transferable by indorsement, had once become established, the practice of making promissory notes payable to order, and of transferring them by indorsement, as had been done with bills of exchange, speedily prevailed. And for some time the courts of law acted upon the usage with reference to promissory notes, as well as with reference to bills of exchange.

In 1680, in the case of *Sheldon v. Hentley*, 2 Show. 160, an action was brought on a note under seal by which the defendant promised to pay to bearer £100, and it was objected that the note was void because not payable to a specific person. But it was said by the court: "*Traditio facit chartam loqui*, and by the delivery, he (the maker) expounds the person before meant, as when a merchant promises to pay to the bearer of the note, any one that brings the note shall be paid." Jones, J., said that "it was the custom of merchants that made that good."

In *Bromwich v. Lloyd*, 2 Lutw. 1582, the plaintiff declared upon the custom of merchants in London on a note for money payable on demand, and recovered; and Treby, C. J., "said that bills of exchange were originally between foreigners and merchants trading with the English. Afterwards, when such bills came to be more frequent, then they were allowed between merchants trading in England, and afterwards between any traders whatsoever, and now between any persons, whether trading or

not; and therefore the plaintiff need not allege any custom, for now those bills were of that general use that upon an *indebitatus assumpsit* they may be given in evidence upon the trial." To which Powell, J., added: "On *indebitatus assumpsit* for money received to the use of plaintiff the bill may be left to the jury to determine whether it was given for value received." In *Williams v. Williams,* Carth. 269, where the plaintiff brought his action as indorsee against the payee and indorser of a promissory note, declaring on the custom of merchants, it was objected on error that, the note having been made in London, the custom, if any, should have been laid as the custom of London. It was answered "that this custom of merchants was part of the common law, and the court would take notice of it ex-officio; and therefore it was needless to set forth the custom specially in the declaration, but it was sufficient to say that such a person '*secundum usum et consuetudinem mercatorum,*' drew the bill." And the plaintiff had judgment.

Thus far the practice of merchants, traders and others of treating promissory notes, whether payable to bearer or order, on the same footing as bills of exchange, had received the sanction of the courts, but, Holt having become chief justice, a somewhat unseemly conflict arose between him and the merchants as to the negotiability of promissory notes, whether payable to order or to bearer; the chief justice taking what must now be admitted to have been a narrow-minded view of the matter, setting his face strongly against the negotiability of these instruments, contrary, as we are told by authority, to the opinion of Westminster Hall, and in a series of successive cases persisting in holding them not to be negotiable by indorsement or delivery.

The inconvenience to trade arising therefrom led to the passing of the statute of 3 and 4 Anne, c. 9, whereby promissory notes were made capable of being assigned by indorsement or made payable to bearer, and such assignment was thus rendered valid beyond dispute or difficulty. It is obvious from the preamble of the statute, which merely recites that: "it had been held that such notes were not within the custom of merchants," that these decisions were not acceptable to the profession or the country. Nor can there be much doubt that by the usage prevalent amongst merchants these notes had been treated as securities negotiable by the customary method of assignment, as much as bills of exchange, properly so-called. The statute of Anne may, indeed, practically speaking, be looked upon as a declaratory statute, confirming the decisions prior to the time of Lord Holt.

We now arrive at an epoch when a new form of security for money, namely, goldsmiths' or bankers' notes, came into general use. Holding them to be part of the currency of the country as cash, Lord Mansfield and the Court of King's Bench had no difficulty in holding in *Miller v. Race,* 1 Burrows 452, that the property in such a note passes, like that in cash, by delivery, and that a party taking it *bona fide,* and for value, is consequently entitled to hold it against a former owner from whom it has been stolen.

In like manner it was held, in *Collins v. Martin,* 1 Bos. & P. 648, that where bills indorsed in blank had been deposited with a banker, to be received when due, and the latter had pledged them with another banker as security for a loan, the owner could not bring trover to recover them from the holder. Both these decisions, of course, proceeded on the ground that the property in the bank note payable to bearer passed by delivery, that in the bill of exchange by indorsement in blank, provided the acquisition had been made *bona fide.*

A similar question arose in *Wookey v. Pole,* 4 Barn. & Ald., 1, in respect of an exchequer bill, notoriously a security of modern growth. These securities being made in favor of blank or order, contained this clause, "if the blank is not filled up, the bill will be paid to bearer." Such an exchequer bill having been placed, without the blank being filled up, in the hands of the plaintiff's agent, had been deposited by him with the defendants, on a *bona fide* advance of money. It was held by three judges of the Queen's Bench—(Bayley, J., *dissentiente*)—that an exchequer bill was a negotiable security, and judgment was therefore given for the defendants. The judgment of Holroyd, J., goes fully into the subject, pointing out the distinction between money and instruments which are the representatives of money and other forms of property. "The courts," he says, "have considered these instruments either promises or orders for the payment of money, or instruments entitling the holder to a sum of money as being appendages to money, and following the nature of their principal." After referring to the authorities, he proceeds: "These authorities show that not only money itself may pass, and the right to it may arise, by currency alone, but, further, that these mercantile instruments, which entitle the bearer of them to money, may also pass, and the right to them may arise, in like manner, by currency or delivery. These decisions proceed upon the nature of the property (*i.e.,* money) to which such instruments give the right, and which is in itself current, and the effect of the instruments, which either give to their holders, merely as such, a right to

receive the money, or specify them as the persons entitled to receive it.''

Another very remarkable instance of the efficacy of usage is to be found in much more recent times. It is notorious that, with the exception of the Bank of England, the system of banking has recently undergone an entire change. Instead of the banker issuing his own notes in return for the money of the customer deposited with him, he gives credit in account to the depositor, and leaves it to the latter to draw upon him, to bearer or order, by what is now called a ''check.'' Upon this state of things the general course of dealing between bankers and their customers has attached incidents previously unknown, and these, by the decisions of the courts, have become fixed law. Thus, while an ordinary drawee, although in possession of funds of the drawer, is not bound to accept, unless by his own agreement or consent, the banker, if he has funds, is bound to pay on presentation of a check on demand. Even admission of funds is not sufficient to bind an ordinary drawee, while it is sufficient with a banker; and the money deposited with a banker is not only money lent, but the banker is bound to pay it when called for by the draft of the customer. See *Pott v. Clegg,* 16 Mees. & W., 321. Besides this, a custom has grown up among bankers themselves of marking checks as good for the purposes of clearance by which they become bound to one another. Though not immediately to the present purpose, bills of lading may also be referred to as an instance of how general mercantile usage may give effect to a writing which without it would not have had that effect at common law. It is from mercantile usage, as proved in evidence, and ratified by judicial decision in the great case of *Lickbarrow v. Mason,* 2 Term. R. 63, that the efficacy of bills of lading to pass the property in goods is derived.

It thus appears that all these instruments, which are said to have derived their negotiability from the law merchant, had their origin, and that at no very remote period, in mercantile usage, and were adopted into the law by our courts as being in conformity with the usages of trade; of which, if it were needed, a further confirmation might be found in the fact that according to the old form of declaring on bills of exchange, the declaration always was founded on the customs of merchants. . . .

§318. *The History of Negotiable Instruments.*—Lord Cockburn here states the orthodox learning on the subject of the history of negotiable instruments as a part of Anglo-American

law.[1] The later part of this history is quite clear—how the rules originated in the custom of merchants, how they were at first applicable only to foreign bills of exchange, later to inland bills and promissory notes, how originally they were applicable only to mercantile transactions and later to all transactions drawn up in the requisite form. As to the earlier history, however, the state of scholarship in Lord Cockburn's day was not such as to permit him to speak with authority. In the first place, he draws the erroneous conclusion from the fact that the first case in the English books, that is to say, in the books recording the decisions of the king's courts, bears the date 1603, that negotiable instruments were hardly known in England at an earlier date. As a matter of fact, they were well known to merchants in the thirteenth century and the reason for their absence from the king's courts prior to Lord Cockburn's day is simply that there were special courts already in existence in which merchants' cases were normally adjudicated. Furthermore, his indirect reference to Malynes' *Lex Mercatoria* is misleading. Far from stating that bills of exchange were unknown in England, that learned merchant is careful to give the forms in use for such bills of exchange between London and Amsterdam (at page 393 of the original edition, 1622). The third part of his work (pp. 378-501 of the original edition) is devoted to "exchanges for moneys by bill of exchange."

Cockburn mentions the use of such instruments by the Italian bankers in the Middle Ages. Just how they came to be of use in Mediæval Europe we do not know, but it is interesting that documents of indebtedness were unknown to Roman law, except in the form of syngraphs and chirographs used by Greek bankers. On the other hand, in the Orient, they had reached a high state of development before the date of the Twelve Tables. In Babylon the records of the great banking house of Egibi of the sixth and following century B. C. show that documents of credit of the nature of promissory notes, together with such practices as endorsement, the drawing of checks on banks and the like were highly developed. Compare

[1] *Cf.* §3, *supra*, for further details.

Kohler, *Allgemeine Rechtsgeschichte* (1914), page 64. It has been suggested as a possibility that documents of credit were introduced into Europe by the Jewish money lenders of the Middle Ages. If so, it is likely that the Jews copied the banking system of Babylonia, where their legal literature was developed to its highest point in the first six centuries A. D. The Hebrew word for bill or note (*Shetar,* the word from which, according to Blackstone, the Star Chamber got its name) is like many other legal and commercial terms in Neo-Hebrew of Babylonian origin.

§319. *From A. M. Kidd,* 2 *Cal L. Rev.* 377: *The Law Merchant and California Decisions.*—"England before and for a long time after the Norman Conquest was not a commercial country. Contractual relations did not play a prominent part in daily life, and the law of contract, therefore, existed only in a rudimentary stage. It took centuries to develop the modern theory of a contract by simple agreement between the parties.[1] Commercial growth required not only the enforcement of business agreements, but also the assignability of the contract created. This notion of assignability also grew slowly. The idea that 'A,' who had become bound to 'B,' could, without his own consent, become bound to 'C,' was a difficult one to grasp. The history of the severity of execution on delinquent debtors must have left its mark as a part of the race experience. 'A' might be willing to take the risk of default in dealing with 'B,' but not in dealing with 'C'[2] There were also technical difficulties in connection with the form that such an assignment should take. There was nothing to be visibly and openly transferred, until it became common to put contracts in the form of a document and to regard the contract as embodied in the document.[3] Commercial development, however, demanded the assignability of contracts. It took a court of equity to work out the process in England, aided perhaps by the fact that the early English law operated very favorably to creditors—but the method is unimportant—the result is that assignability of con-

[1]Pollock and Maitland, *History of Eng. Law,* vol. II, 184.

[2]Loyd, 62 Univ. of Pa. Law Rev. 354.

[3]Pollock and Maitland, *History of Eng. Law,* vol. II, p. 226, Jenks in *Select Essays in Anglo-American History,* vol. III, p. 65.

tract is today the rule. The obligor can always protect himself, if he wishes, by expressly providing that the contract shall not be assigned and by using apt words to accomplish that purpose.[4]

The merchants in England, many of them foreigners, with whom contract was a part of their daily business, worked out independently the assignability of contracts, and, for certain instruments, an assignability free from equities which the obligor could have set up against the assignor and free from infirmities in the title of intermediate holders. These two characteristics are commonly called 'negotiability.' Negotiability, however, has never been extended to ordinary contracts, and this is in accord with modern ideas. An ordinary contract is assignable, not negotiable. Commercial paper, like bills and notes, however, is an instrument of credit, performing in part the functions of money, and must, therefore, like money, pass freely from hand to hand. The intention of the parties is that the instrument shall have the additional value which comes from the bona-fide purchaser taking free and clear of equities. An ordinary contract, however, is made to be performed, not assigned. Assignment is not usually contemplated, and it is, therefore, better to require the assignee to find out, at his peril, whether the obligor has a defense, than to facilitate dishonesty by permitting one who has obtained a contract by fraud to assign it free from such defenses. The business man who buys an ordinary contract knows that he is getting nothing more than the right of his assignor. It is a question not of principle, but of policy, like the corresponding law of chattels. In London the law of market overt prevails. A purchaser from a shop gets title whether the shopkeeper owned the goods or not.[5] In Germany a purchaser at public auction is protected.[6] The French law also favors the purchaser.[7] In the United States it is considered better that the honest purchaser should occasionally lose

[4]*Dollar v. Internatl. Banking Corp.* (1909), 10 Cal. App. 83, 101 Pac. 34.

[5]Ency. of the Laws of Eng., vol. IX, p. 3; *Hargreave v. Spink* (1892), 1 Q. B. 25; see *Clayton v. LeRoy* (1911), 2 K. B. 1031.

[6]German Civ. Code, §§929-935.

[7]French Civ. Code, §§2279-2280.

the property than that theft should be encouraged by affording a ready market for stolen goods. . . .

It is the mechanical theory of law that Westminster Hall must give law to Lombard Street; that business is made for the law and not the law for business. It is, of course, true that the judge cannot in all cases give effect to the desires of the commercial world. It is the function of courts to examine the agreements of business men and the usages of business to see whether they accord with the general welfare, and to forbid such dealings with property and such contracts as are inimical to the public good. The courts have, accordingly, prohibited perpetuities, created an equity of redemption, forbidden contracts in restraint of trade, and, in a multitude of cases, have exercised their proper authority in adjusting the interests of the individual or groups of individuals to the interest of the social whole. In this matter of the negotiability of bonds, all classes, bankers, brokers, investors, desire negotiability, and have assumed it in their transactions. If title is to be proved in each case, it creates a difficulty for the investor and a risk for the bank. The bank is less likely to lend and must charge a higher interest rate. As the ancient judges, with little or no help from legislation, worked out a theory of contracts, a theory of assignability, and a law of bills and notes to meet the expanding commercial needs, so the modern judges, in nearly every jurisdiction, have continued to meet changing conditions according to the spirit of the common law by giving effect to new forms of instruments, as created by business men. Accordingly, bonds are nearly everywhere held negotiable." . . .

§320. *From M. D. Chalmers. A Treatise on the Law of Bills of Exchange, Promissory Notes and Checks. Introduction.*— "The results of this formation of the law of bills and notes by custom are instructive. A reference to Marius' treatise on *Bills of Exchange,* written about 1670, or Beawes' *Lex Mercatoria,* written about 1720, will show that the law, or perhaps rather the practice, as to Bills of Exchange, was even then pretty well defined. Comparing the usage of that time with the law as it now stands, it will be seen that it has been modified in some important

respects. Comparing English law with French, it will be seen that, for the most part, where they differ, French law is in strict accordance with the rules laid down by Beawes. The fact is, that when Beawes wrote, the law or practice of both nations on this subject was uniform. The French law, however, was embodied in a Code by the '*Ordonnance de* 1673,' which is amplified but substantially adopted by the *Code de Commerce* of 1818. Its development was thus arrested, and it remains in substance what it was 200 years ago. English law has been developed piecemeal by judicial decision founded on custom. The result has been to work out a theory of bills widely different from the original. The English theory may be called the Banking or Currency theory as opposed to the French or Mercantile theory. A Bill of Exchange in its origin was an instrument by which a trade debt, due in one place, was transferred in another. It merely avoided the necessity of transmitting cash from place to place. This theory the French law steadily keeps in view. In England bills have developed into a perfectly flexible paper currency. In France a bill represents a trade transaction; in England it is merely an instrument of credit. English law gives full play to the system of accommodation paper; French law endeavors to stamp it out. A comparison of some of the main points of divergence between English and French law will show how the two theories are worked out. In England it is no longer necessary to express on a bill that value has been given, for the law raises a presumption to that effect. In France the nature of the value must be expressed, and a false statement of value avoids the bill in the hands of all parties with notice. In England a bill may now be drawn and payable in the same place (formerly it was otherwise, see the definition of bill in Comyn's *Digest*).[1] In France the place where a bill is drawn must be so far distant from the place where it is payable, that there may be a possible rate of exchange between the two. A false statement of places, so as to evade this rule avoids the bill in the

[1] "A bill of exchange is when a man takes money in one country or city upon exchange, and draws a bill whereby he directs another person in another country or city to pay so much to A or order for value received of B, and subscribes it."

hands of a holder with notice. As French lawyers put it, a Bill of Exchange necessarily presupposes a contract of exchange.[2] In England (since 1765) a bill may be drawn payable to bearer [though formerly it was otherwise.][3] In France it must be payable to order; if it were not so, it is clear that the rule requiring the consideration to be expressed would be an absurdity. In England a bill originally payable to order becomes payable to bearer when indorsed in blank. In France an indorsement in blank merely operates as a procuration. An indorsement, to operate as a negotiation, must be an indorsement to order, and must state the consideration; in short, it must conform to the condition of an original draft. In England, if a bill be refused acceptance, a right of action at once accrues to the holder. This is a logical consequence of the currency theory. In France no cause of action arises unless the bill is again dishonored at maturity; the holder, in the meantime, is only entitled to demand security from the drawer and indorsers. In England a sharp distinction is drawn between current and overdue bills. In France no such distinction is drawn. In England no protest is required in the case of an inland bill, notice of dishonor alone being sufficient. In France every dishonored bill must be protested. Grave doubts may exist as to whether the English or the French system is the soundest and most beneficial to the mercantile community, but this is a problem which it is beyond the province of a lawyer to attempt to solve."

§321. *From Zechariah Chafee, Jr., Acceleration Provisions in Time Paper.* 32 *Harv. L. R.* 747, 749.—"The conflict between mercantile understanding and judicial decision may have far-reaching consequences in the business world. The cases are not unanimous against negotiability, and the legal problem of the effect of these acceleration provisions in collateral time paper is still unsettled. It is therefore worth while to examine the rules of the law of negotiable instruments which are said to be violated by these provisions, and the application of those rules to still other types of paper, which also have a fixed date for pay-

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[2]This rule is said to be now obsolete, but the Code remains unaltered.

[3]See *Stewart v. Hodges* (1692), 12 Mod. 36.

ment but mature earlier upon the happening of some event. It will then be possible to determine whether the bank form of promissory notes and the chattel notes are rendered not negotiable by their acceleration clauses.

A negotiable instrument is a substitute for money. It was first used to aid in the payment of money at distant points, and the international bill of exchange still serves that purpose. As an addition to money it increases the purchasing medium in circulation. For instance, if many people did not pay their monthly bills by checks, more specie or paper money would be needed in circulation, and economically as well as practically there is often not enough money to go round. The manufacturer who cannot obtain cash from his customers insists upon a note or accepted bill instead, which he can immediately discount at his bank and turn into money for his pay roll. The bank in turn rediscounts the bill or note with the Federal Reserve Bank, which makes it part of its reserve for the issue of more money in the form of bank notes. Like money a negotiable instrument is intended to have a definite value and to be taken almost at sight, free from the need of investigation into outside facts and unaffected by the claims of former owners, even if it was stolen or lost. When genuine, it ought to serve as the equivalent of money, except for the distant maturity and the risk of insolvency of private persons and their legal incapacity.

Anything so closely related to money and circulating almost as rapidly must be plainly distinguishable from the ordinary non-transferable written contract, just as a five-dollar gold piece is distinguishable from uncoined gold. Therefore, business custom has established several 'formal requisites' for a negotiable instrument, which adapt it for quick circulation and give it an unmistakable label. Although the law usually cares little about the form of a contract and looks to the actual understanding of the parties who made it, the form of a negotiable instrument is essential for the security of mercantile transactions. The courts ought to enforce these requisites of commercial paper at the risk of hardship in particular cases. A business man must be able to tell at a glance whether he is taking commercial paper or

not. There must be no twilight zone between negotiable instruments and simple contracts. If doubtful instruments are sometimes held to be negotiable, prospective purchasers of queer paper will be encouraged to take a chance with the hope that an indulgent judge will call it negotiable. On the same principle, if trains habitually left late, more people would miss trains than under a system of rigid punctuality.

A few careless persons must be sacrificed so that the world at large will know just what the rule is and regulate its affairs accordingly. Consequently, as Chief Justice Emery puts it:[1]

> Commercial paper has long been governed by special rules which, while designed to ensure justice, are also designed to ensure the free and safe use of an indispensable commercial agency. The commercial world needs and seeks for the plain workable rule rather than for the somewhat abstract right in each case.

It must not be forgotten, however, that these rules of certainty are not mathematical formulæ evolved out of the pure reason of the judges, but are business requirements created by business needs and susceptible of modification with changing commercial conditions. Law is made for business, not business for law. While the influence of custom on legal principles has sometimes been exaggerated,[2] the history of negotiable instruments leaves no doubt that the courts have based the governing principles upon actual commercial practice, though modifying it when it seemed unreasonable or out of accord with general considerations of justice.[3] Judge Amidon remarks with his refreshing common sense:[4]

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[1] *Neal v. Coburn*, 92 Me. 139, 145, 42 Atl. 348 (1898).

[2] J. C. Carter, *Law, Its Origin, Growth, and Function;* criticized by J. C. Gray, *The Nature and Sources of the Law*, §§598-641.

[3] *Goodwin v. Robarts*, L. R. 10 Ex. 337 (1875); 2 Campbell's *Lives of the Chief Justices*, 407, and note, London, 1849.

[4] *Cudahy Packing Co. v. State National Bank*, 134 Fed. 538, 542-43 (C. C. A., 8th, 1904). For presentations of a similar view as to corporate bonds, see 2 Machen on *Corporations*, §1734 *ff.* *Edelstein v. Schuler* (1902), 2 K. B. 144; *Mercer County v. Hacket*, 1 Wall. (U. S.), 83, 95 (1863), per Grier, J.: "A mere technical dogma of the courts or the common law cannot prohibit the commercial world from inventing or using any species of security not known in the last century.

'The rule requiring certainty in commercial paper was a rule of commerce before it was a rule of law. It requires commercial, not mathematical certainty. An uncertainty which does not impair the functions of negotiable instruments in the judgment of business men ought not to be regarded by the courts. The fine phrase of Chief Justice Gibson in the case of *Overton v. Tyler*, 3 Pa. 346, . . . that a negotiable instrument "is a courier without luggage," has been made to do much service in the discussion of this subject. The real question, however, is who shall determine what constitutes "luggage"—the business world, or the judge in his library? In no branch of the law has the sound judgment of the English courts shown itself more conspicuously than in the treatment of this subject. Whenever a new instrument, varying in some of its features, from the ordinary promissory note or bill of exchange, has been presented for admission to the class of commercial paper, those courts have called for their guidance men from the actual business world, best qualified to speak on the subject. If, from their evidence, it has appeared that the instrument in question was by the general custom and practice of the business world treated as a negotiable instrument, the court has given effect to that usage, and adjudged the instrument to be subject to the same law as other negotiable paper. This was true not only in the early and formative periods of the commercial law, coming down to the age of Lord Mansfield, but has been followed with the same freedom from time to time down to the current year. Those courts have never forsaken the business world to pursue a definition.' "

§322. *From The Negotiable Instruments Law.*

Article 1—Form and Interpretation.

Section 1. Be it enacted, etc., an instrument to be negotiable must conform to the following requirements:

Usages of trade and commerce are acknowledged by courts as part of the common law, although they may have been unknown to Bracton or Blackstone. And this malleability to suit the necessities and usages of the mercantile and commercial world is one of the most valuable characteristics of the common law." *First National Bank of Springfield, Ohio v. Skeen*, 101 Mo. 683, 687, 14 S. W. 732 (1890). The unfortunate results of a rigid *a priori* doctrine are pointed out by Professor A. M. Kidd in 6 Cal. L. Rev. 444 (1918).

1. It must be in writing and signed by the maker or drawer;

2. Must contain an unconditional promise or order to pay a sum certain in money;

3. Must be payable on demand, or at a fixed or determinable future time;

4. Must be payable to order or to bearer; and,

5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

Sec. 2. The sum payable is a sum certain within the meaning of this act, although it is to be paid

1. With interest; or

2. By stated installments; or

3. By stated installments, with a provision that upon default in payment of any installment or of interest the whole shall become due; or

4. With exchange, whether at a fixed rate, or at the current rate; or

5. With costs of collection or an attorney's fee, in case payment shall not be made at maturity.

Sec. 3. An unqualified order or promise to pay is unconditional within the meaning of this act, though coupled with—

1. An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount; or

2. A statement of the transaction which gives rise to the instrument.

But an order or promise to pay out of a particular fund is not unconditional.

Sec. 4. An instrument is payable at a determinable future time, within the meaning of this act, which is expressed to be payable

1. At a fixed period after date or sight; or

2. On or before a fixed or determinable future time specified therein; or

3. On or at a fixed period after the occurrence of a

specified event, which is certain to happen, though the time of happening be uncertain.

An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect.

Sec. 5. An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable. But the negotiable character of an instrument otherwise negotiable is not affected by a provision which

1. Authorizes the sale of collateral securities in case the instrument be not paid at maturity; or

2. Authorizes a confession of judgment if the instrument be not paid at maturity; or

3. Waives the benefit of any law intended for the advantage or protection of the obligor; or

4. Gives the holder an election to require something to be done in lieu of payment of money.

But nothing in this section shall validate any provision or stipulation otherwise illegal.

Sec. 6. The validity and negotiable character of an instrument are not affected by the fact that

1. It is not dated; or

2. Does not specify the value given, or that any value has been given therefor; or

3. Does not specify the place where it is drawn or the place where it is payable; or

4. Bears a seal; or

5. Designates a particular kind of current money in which payment is to be made.

But nothing in this section shall alter or repeal any statute requiring in certain cases the nature of the consideration to be stated in the instrument.

Sec. 7. An instrument is payable on demand;

1. Where it is expressed to be payable on demand, or at sight, or on presentation; or

2. In which no time for payment is expressed.

Where an instrument is issued, accepted, or indorsed when overdue, it is, as regards the person so issuing, accepting, or indorsing, payable on demand.

Sec. 8. The instrument is payable to order where it is drawn payable to the order of a specified person or to him or his order. It may be drawn payable to the order of

1. A payee who is not maker, drawer, or drawee; or
2. The drawer or maker; or
3. The drawee; or
4. Two or more payees jointly; or
5. One or some of several payees; or
6. The holder of an office for the time being.

Where the instrument is payable to order the payee must be named or otherwise indicated therein with reasonable certainty.

Sec. 9. The instrument is payable to bearer

1. When it is expressed to be so payable; or
2. When it is payable to a person named therein or bearer; or
3. When it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable; or
4. When the name of the payee does not purport to be the name of any person; or
5. When the only or last indorsement is an indorsement in blank.

Sec. 10. The instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements hereof.

§323. *The Negotiable Instruments Law, Section* 20.—Where the instrument contains or a person adds to his signature words indicating that he signs for or on behalf of a principal, or in a representative capacity, he is not liable on the instrument if he was duly authorized; but the mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability.

§324. *From J. D. Brannan, The Negotiable Instruments Law* (third edition, 1919).

The preceding section is commented on as follows:

The plain language of this section indicates that it was the intention of the draftsman and the commissioners to clear up the unnecessary and unpardonable confusion caused by the failure of some of the courts to exercise a little common sense and to recognize mercantile usage. Much of the difficulty found in this subject is purely manufactured and would not trouble a business man for a moment. He would perceive no difference between notes signed, "The X Co. by A, Pres.," or signed "The X Co., A, Pres.," or signed "X Co., A, Pres.," or " A, Pres., X Co." or a note reading "The X Co. promises to pay" and signed "A, Pres." Yet courts have been found to make distinctions in such cases. For instance, in *Reeve v. First N. Bank,* 54 N. J. L. 208, 23 Atl. 853, 16 L. R. A. 143, a note signed "Warrick Glass Works, J. Price Warrick, Pres.," was properly held to be the note of the corporation, and not the note of Warrick or the joint note of Warrick and the corporation; so also in *Aungst v. Creque,* 72 Oh. St. 551, 74 N. E. 1073. Whereas in *McCandless v. Belle Plaine Co.,* 78 Iowa, 161, 42 N. W. 635, 4 L. R. A. 396, it was held that such a note is the note of the signer, that oral evidence was not admissible to show that the corporation alone was intended and that both were liable. And in *Day v. Ramsdell,* 90 Iowa, 731, 52 N. W. 208, a note reciting that, "We, the A. B. Co., promise to pay," but signed merely by two persons describing themselves as President and Secretary, was held to be their individual obligation. In 17 Banking Law Journal, 305-306, it was properly said that "nine business men out of ten would regard such a note as that of the company," and it would hardly be an exaggeration to include the tenth man. The same New Jersey court that decided *Reeve v. First Bank, supra,* also said in the same case that a note signed "J. Price, Pres., Warrick Glass Works," nothing appearing in the body of the note to indicate who is the maker, is *prima facie* the note of J. Price. Here again a business man would regard this as a note of the company. In *Miller v. Roach,* 150 Mass. 140, 22 N. E. 634, 6 L. R. A. 71, a note reciting "We promise to pay," was signed

"John Roach, Treas." Stamped on the paper was the impression of a large circular seal, around the edge of which was printed the name of a company so placed that the circumference passed through the final letter of Roach and the word treasurer. This was held to be the note of the company. Whereas in *Dutton v. Marsh*, L. R. 6 Q. B. 361, where a note reciting "We, the directors of the A. B. Co., promise, etc.," was signed by four persons, one of whom added the word "Chairman" after his name, with the company's seal in the corner, it was held that the signers were individually liable, that the affixing of the seal was not enough to exclude personal liability and to show that it was the company's note. Distinctions have been made between the case of a note signed "A. B. Agent, C. D. Co.," and a note signed "A. B. Agent for C. D. Co.," it being held that in the former case A. B. was personally liable, in the latter that he was not. *Barker v. Mechanic Ins. Co.*, 3 Wend. 94. Here again a business man would see no distinction. He would regard both signatures as being made on behalf of the company.

In some states where the name of a company is printed at the head or on the margin of the instrument and the note is signed "A. B., Pres.," for instance, the instrument has been held to be sometimes presumptively, sometimes conclusively, the instrument of the company. *Second Bank v. Midland Co.*, 155 Ind. 581. See also, *Carpenter v. Farnsworth*, 106 Mass. 561, where the court said (p. 562): "The court has always laid hold of any indication on the face of the paper, however informally expressed, to enable it to carry out the intention of the parties."

On the other hand, the contrary has been held in *C. N. Bank v. Clark*, 139 N. Y. 307, and *First Nat. Bank v. Wallis*, 150 N. Y. 455. Some courts have treated the instruments in some of these cases as ambiguous and have admitted parol evidence to show the intention of the parties. It is submitted that a court wishing to construe the language of section 20 in accordance with the evident intention of the draftsman and not disposed to interpret it with a desire to adhere to any former rule in the state, ought to find little difficulty in these cases. Section 20

is taken from section 26 of the Bills of Exchange Act, but is made stronger by the addition of the words "where the instrument contains," which are not to be found in the section of the Bills of Exchange Act. Notes signed by individuals with the addition of such words as agent, president, secretary and the like, without disclosing any principal, either in connection with the signatures or in the body of the instrument, naturally had to be treated as the notes of the individuals because the doctrine of undisclosed principal had not been applied to contracts made in the form of negotiable instruments, and therefore, unless the signer could be held the notes would be invalid. This limitation of the doctrine of undisclosed principal was proper because that doctrine would impair the value of the negotiable instruments for purposes of circulation. But it seems a narrow view and not in accordance with mercantile understanding to impose individual liability upon a signer who, being duly authorized to sign, discloses the name of a principal on the instrument, and indicates that he himself is an agent or officer, without regard to the form in which this is done. And it is submitted that such a person is within the meaning of the words of section 20 providing that "where the instrument contains, or the person adds to his signature, words indicating that he signs for or on behalf of a principal or in a representative capacity, he is not liable on the instrument if he was duly authorized." In most of the cases decided since the act, the courts have construed the act in this reasonable manner, but some courts unfortunately have seemed unwilling to depart from the old rule of the state, where it was different, and have held that the statute makes no change.

§325. *The Codification of the Negotiable Instruments Law.*—In both England and America, the laws of negotiable instruments have been reduced to a systematic code. Questions pertaining to negotiable instruments are, therefore, today largely questions of statutory interpretation.[1]

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[1]For annotated editions of the Negotiable Instruments Law, see Brannan, *Negotiable Instruments Law*, 3rd edition, 1919; Terry, Uniform State Laws in the U. S. 1920; and Williston, *Contracts*, vol. 2, 1920.

In the interpretation of the code, there have been two tendencies, as is brought out in Lord Herschell's opinion in *Bank of England v. Vagliano.*

§326 *BANK OF ENGLAND v. VAGLIANO BROS.*

House of Lords, 1891. [1891, *A. C.* 107.]

[Section 7, subsec. 3, of the English Bills of Exchange Act reads: ''Where the payee is a fictitious or non-existing person the bill may be treated as payable to bearer.'' In interpreting the section it was held that a bill payable to a real person not intended by the drawer to have any interest in it is payable to a ''fictitious person'' and is to be treated as payable to bearer and that the acceptor's ignorance of the fiction is immaterial. On the principles of interpretation of codified law Lord Herschell commented as follows:]

LORD HERSCHELL: My Lords, with sincere respect for the learned judges who have taken this view, I cannot bring myself to think that this is the proper way to deal with such a statute as the Bills of Exchange Act, which was intended to be a code of the law relating to negotiable instruments. I think the proper course is in the first instance to examine the language of the statute and to ask what is its natural meaning, uninfluenced by any considerations derived from the previous state of the law, and not to start with inquiring how the law previously stood, and then, assuming that it was probably intended to leave it unaltered, to see if the words of the enactment will bear an interpretation in comformity with this view.

If a statute, intended to embody in a code a particular branch of the law, is to be treated in this fashion, it appears to me that its utility will be almost entirely destroyed, and the very object with which it was enacted will be frustrated. The purpose of such a statute surely was that on any point specifically dealt with by it, the law should be ascertained by interpreting the language used instead of, as before, by roaming over a vast number of authorities in order to discover what the law was, extracting it by a minute critical examination of the prior decisions, dependent upon a knowledge of the exact effect even of an obsolete proceeding such as a demurrer to evidence. I am of course far from asserting that resort may never be had to the previous state of the law for the purpose of aiding in the construction of the provisions of the code. If, for example, a provision be of doubtful import, such resort would be perfectly legitimate. Or, again, if in a code of the law of negotiable instruments words be found which have previously acquired a

technical meaning, or been used in a sense other than their ordinary one, in relation to such instruments, the same interpretation might well be put upon them in the code. I give these as examples merely; they, of course, do not exhaust the category. What, however, I am venturing to insist upon, is that the first step taken should be to interpret the language of the statute, and that an appeal to earlier decisions can only be justified on some special ground.

One further remark I have to make before I proceed to consider the language of the statute. The Bills of Exchange Act was certainly not intended to be merely a code of the existing law. It is not open to question that it was intended to alter, and did alter it in certain respects. And I do not think that it is to be presumed that any particular provision was intended to be a statement of the existing law, rather than a substituted enactment. . . .

§327. *The Problem of Interpretation of the Code.*—The foregoing discussion makes it plain that codification does not of itself put an end to the difficulties and ambiguities of the law. Lord Herschell contrasts two general theories with respect to the interpretation of the Code. The first is that we should begin with the assumption that the code was intended to "codify," that is, to state in a concise, connected form the law as it was when the code was adopted. On the basis of this assumption, the language of the code is of little or no importance. This assumption, however, is vigorously rejected by Lord Herschell in favor of the second—that a code is like any other statute and that its language is the first and paramount consideration; that it is just as likely to have been intended to change the law as to perpetuate the law in its old form. This latter assumption is quite in keeping with the nineteenth century Anglo-American attitude towards statutes inherited from the time when statutes were entirely exceptional and passed presumably to remedy defects in the existing common law. Blackstone, it is true, recognized the existence of declaratory, as well as remedial statutes, but his conception of declaratory acts is limited to cases "where the old custom of the kingdom is almost fallen into disuse or become disputable." He then goes on to state: "There are three points to be considered in the construction of all remedial statutes; the old law, the

mischief and the remedy: that is, how the common law stood at the making of the act; what the mischief was, for which the common law did not provide; and what remedy the Parliament hath provided to cure this mischief. And it is the business of the judges so to construe the act, as to suppress the mischief and advance the remedy." (I Blackstone *Commentaries* *87.)

His followers accordingly concentrated their attention on his rules for the construction of remedial statutes.

A very similar controversy develops in all countries in which codification has gained a foothold. In modern Germany, for example, there are those who advocate a literal interpretation of the code (after the manner of Planck), and those who seek emancipation from the letter of the law (*freie Rechstfindung*) through reading into the Code something more significant than the conscious intent of the legislature, with the aid of history or philosophy. For a discussion of their points of view in English, see *Science of Legal Method,* (Vol. 9 of the Modern Legal Philosophy Series); Pound, *Readings in Roman Law*, 2d ed., pp. 14-21; Isaacs, *The Aftermath of Codification,* 4 Am. Law Sch. Rev. 548, Proceedings of the American Bar Assn., 1920.

§328. *Note on Uniform Construction of the Uniform Acts. From* 29 *Harv. L. Rev.* 541.—"With the widespread adoption of the growing number of Uniform Acts, recommended by the Commissioners on Uniform State Laws, the question of what principles should be applied by the courts in their construction is becoming increasingly important. In a recent case before the Supreme Court it was urged that the Uniform Warehouse Receipts Act was but a step in the development of the state law, and that prior decisions of the state court were safe guides to its construction; but the court rejected that view, and so interpreted the act as to accomplish as far as possible its fundamental purpose to bring the law of the state into harmony with the commercial law of the whole country. *Commercial National Bank of New Orleans v. Canal-Louisiana Bank & Trust Co.,* 239 U. S. 520 (1915).

The Conference of Commissioners on Uniform State Laws

held its first meeting in 1892. Since that time it has approved and recommended for adoption by the states fifteen Uniform Acts. The purpose of the Conference is to secure uniformity of law on matters which from their nature are largely interstate, by voluntary action on the part of all the states since this end is unattainable through the federal government because of constitutional limitations. But obviously, if the courts place diverse constructions on the statutes so as to perpetuate former local doctrines, this attempt to bring order out of chaos will fail of success. Uniformity of the 'judge-made law' is as essential as uniformity of the statute law. In many cases the courts have recognized the purpose of the Uniform Acts, and have construed them liberally, examining decisions from other courts under the same sections of the acts in order to secure uniformity, even though this may have necessitated a change from the old rule in their own state. But a number of courts have ignored the ideal and have placed a strict construction on the acts, in favor of the law as declared in their own decisions before the adoption of the statutes, often without any examination of the decisions in other states.

As the Negotiable Instruments Law is the oldest and the most widely adopted of the Uniform Acts, it has been interpreted the most frequently; but the way the courts deal with it typifies their attitude toward the others. The Louisiana court, overlooking the Negotiable Instruments Law and following the former rule of the state, held that an anomalous indorser was presumed to be, not an indorser, but a surety. The Nebraska Court decided that a check was still an assignment under the law, clinging to its former doctrine and citing no cases from other jurisdictions, though Virginia had previously reached the opposite conclusion. Other courts have failed to refer to the law at all in cases to which it applied. The New York courts have been among the worst offenders, frequently ignoring the law entirely, and very rarely citing any decisions except their own former ones. They have been very reluctant to admit that any former rules are changed by the law. As an illustration, the New York doctrine that one receiving a note as collateral security for a pre-existing debt was not a holder for value, was

declared by the first case after the adoption of the law to be changed, the result which was reached by courts of other states which had previously held the New York view; but later New York cases, not citing decisions from any other jurisdiction, held the former rule not altered by the law. The point has not yet been directly decided by the Court of Appeals, so that the final result in New York is still uncertain.[1]

The Commissioners on Uniform Laws recognized the menace to uniformity in the growing divergence in judicial interpretation, and in 1913 they appointed a Committee on Uniformity of Judicial Decisions to combat this tendency. This committee has not only brought the need of a uniform construction to the attention of every court of last resort in the United States, but is also tabulating all the decisions rendered under the commercial acts, and on request furnishes references of all the cases under any section of any act to the courts. The principal case, throwing the influence of the Supreme Court vigorously on the side of uniform construction, is an encouraging sign. It is to be hoped that all the courts will come to recognize the purpose of the acts to secure uniformity, and after freely examining decisions from other states will construe the acts liberally so as to bring their own decisions into accord.[2] Not till then will there be actual uniformity of law."

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[1]In later New York cases there are *dicta* to the effect that the Negotiable Instruments Law has changed the former New York rule. See *King v. Bowling Green Trust Company*, 145 N. Y. App. Div. 398, 402, 129 N. Y. Supp. 977, 980; *Broderick & Bascom Rope Co. v. McGrath*, 81 N. Y. Misc. 199, 201, 142 N. Y. Supp. 490, 498. And it is fair to say that the more recent New York decisions show a more liberal disposition toward the Uniform Acts. *Van Vliet v. Kanter*, 139 N. Y. App. Div. 603, 124 N. Y. Supp. 63; *King v. Bowling Green Trust Co.*, 145 N. Y. App. Div. 398, 120 N. Y. Supp. 977; *Casper v. Kuhne*, 79 N. Y. Misc. 411, 140 N. Y. Supp. 86. "The desirability of uniformity in the laws of various states with reference to negotiable instruments is so obvious, and the legislative intent to harmonize our heretofore conflicting decisions with those of other jurisdictions is, to my mind, so clearly expressed, that full effect should be given thereto." *Broderick & Bascom Rope Co. v. McGrath*, 81 N. Y. Misc. 199, 201, 142 N. Y. Supp. 497, 498.

[2]See Charles Thaddens Terry, *Uniform State Laws in the United States, fully annotated*, edited and published under the auspices and for the purposes of the National Conference of Commissioners on Uniform State Laws, 1920.

§329. *The Negotiable Instrument as a Short Form of Contract.*—The negotiable instrument is a kind of a shorthand form of a large series of typical business contracts. To understand the position of the indorser, in particular, it is necessary to bear in mind that the mere writing of his name in a certain position, that is to say, on the back of the instrument, is equivalent to signing several distinct documents. In the first place, he signs a receipt which, like all receipts, merely creates a rebuttable presumption that he has been paid the amount of money indicated. In the second place, he signs a new document of the tenor of the old one, in which he agrees to pay to the bearer the amount indicated in the original document at the time indicated, subject, however, to the following conditions: that the instrument be presented for payment to the person primarily liable at maturity and in a proper manner; and secondly, that upon that person's failure or refusal to pay, the proper kind of notice of the facts be sent to the indorser immediately.

Presentment for payment and notice of dishonor are no less necessary to charge a drawer than an indorser.

In the case of a bill or check presented outside of the state in which the indorser lives, the facts of presentment and dishonor must be attested by a notary or other authorized person; that is, "protested." Inland (*i.e.* intrastate) bills and notes may be protested and the protest used in court as evidence of presentment and non-payment, but verbal evidence will do as well if it is available.

The technical rules with regard to these requirements of "diligence" are set forth in the Negotiable Instruments Law as follows: presentment for payment, §§70-88; notice of dishonor, §§89-118; presentment for acceptance, §§143-151; protest, §§152-160.

It is hardly necessary to add that presentment for payment and notice of dishonor are not necessary to charge a party who is "primarily liable" on the instrument, that is, the maker of a note or the acceptor of a bill of exchange.

§330 *GIFFORD v. HARDELL.*

Supreme Court of Wisconsin, 1894. [88 *Wis.* 538.]

This action was brought to recover against the defendant, as indorser, the amount of four checks drawn on the Commercial Bank of Milwaukee by one Musselman, in favor of divers persons, and which had been indorsed to the defendant, who on the 17th of July, 1893, sold and indorsed them to the plaintiff. They were indorsed and delivered to the plaintiff's father, at Dousman, Waukesha County, Wis., who at once mailed them to the plaintiff, at New Richmond, Wis. The checks were not presented for payment until the 21st of July, when the Commercial Bank had failed, and were protested for non-payment.

The only question was whether the plaintiff, or his agent, the Manufacturers' Bank of New Richmond, Wis., which undertook the collection of the checks, used due diligence in presenting them for payment. They were forwarded to the plaintiff, at New Richmond, by his father, on the day they were indorsed, and received by him, by due course of mail, July 18, at 5 o'clock p. m., and were at once delivered to said Manufacturers' Bank for collection. It immediately inclosed and mailed the checks to its correspondent in Chicago for collection, according to its usual custom, having no regular bank correspondent in Milwaukee. They were received and forwarded by the National Bank of Illinois, of Chicago, to Milwaukee, Wis., but were not presented for payment until the 21st of July. The Commercial Bank of Milwaukee, upon which they were drawn, failed, closing its doors at the usual hour on the 20th of July. There was a direct mail route from New Richmond to Milwaukee, and thence to Chicago, the latter city being about 85 miles south of Milwaukee. The evening mail of the 18th of July at this time left New Richmond at 8:41 p. m., and would have reached Milwaukee at 11 o'clock of the forenoon of the 19th, and Chicago at about 1 o'clock of the same day; and the checks arriving at Milwaukee, as above stated, could have been presented for payment at 10 o'clock in the morning of the 20th, while the bank on which they were drawn was honoring its checks. The court held that sending them by way of Chicago for collection was not the use of reasonable diligence in presenting them for payment, and directed a verdict for the defendant, and from a judgment thereon in favor of the defendant the plaintiff appealed.

PINNEY, J. (after stating the facts as above): The same rules which exist in relation to the necessity of presentment and

notice, in order to charge the indorser of bills of exchange in general, apply as well to an indorser of a check. A check on a bank is presumed to be drawn against deposited funds, and, unlike a bill of exchange, which need not be drawn on a deposit, is generally designed for immediate payment, and not for circulation. For this reason it is of greater importance than in the case of a bill that a check shall be promptly presented, and the drawer notified of non-payment, so that he may speedily inquire into the cause of refusal, and take prompt measures to secure his funds deposited in the bank. The indorsers of bills and of checks stand on the same footing in reference to the effect of delay or failure in making presentment, or giving notice of non-payment, and are absolutely and entirely discharged if presentment be not made within a reasonable time; and this rule applies as between an indorser and indorsee, as in the present case.

It is plain from the facts that, if the bank at New Richmond had forwarded the checks direct to Milwaukee for collection, they would have been received, at the furthest, in time for presentation and payment on the 20th of July, and while the bank on which they were drawn was transacting its usual business; and it appears that it had ample funds of the drawer, with which to have paid them. The period of reasonable time for presentation, as between the plaintiff and the defendant, as indorser, undoubtedly began when the checks were delivered to the plaintiff's father for him, at Dousman, Waukesha county, Wis., on the 17th of July. Daniel, *Neg. Inst.* §§1586, 1587, and cases in notes. The drawer of a check cannot rightfully withdraw his funds necessary for the payment of it upon proper presentation, and it would be unjust to hold that however long the holder might permit the fund to remain, it should be at the drawer's risk. Hence, the check must be presented within a reasonable time, or the indorser will be discharged, and the fund is at the risk of the holder, if he permits the deposit to remain. No transfer, or series of transfers, can prolong the risk of the drawer or indorser beyond this period, though each party is allowed the same period, as between himself and his immediate predecessor that the payee had as between himself and the drawer; for no transferee can stand on any better footing than his transferrer, in respect to the time within which the check must be presented in order to render the drawer's or previous indorser's liability absolute in the event of the failure of the bank. Daniel, *Neg. Inst.* §1595, and cases in note.

The rule of diligence, as between indorsee and indorser, is

the same as between payee and drawer. This requires, in general, that, where the payee receives the check from the drawer in a place distant from the place where the bank on which it is drawn is located, it will be sufficient for him to forward it by post to some person at the latter place on the next secular day after it is received, and then it will be sufficient for the person to whom it is thus forwarded to present it for payment on the day after it has reached him by due course of mail. When the defendant delivered the checks, properly indorsed, at Dousman, Wis., on the 17th of July, he had a right to assume and expect that the plaintiff, or his father, would present them for payment within a reasonable time, and they took the risk of making such presentment. Instead, they were sent several hundred miles to the northwest of Milwaukee, to New Richmond, and then back, through Milwaukee, to Chicago, and were then returned to Milwaukee for payment on the 21st, as before stated. It is clear that they were not presented for payment within a reasonable time after indorsement and delivery by the defendant, and the judgment of the county court was therefore correct. *First Nat. Bank v. Miller,* 37 Neb. 500, 55 N. W. 1064, 40 Am. St. Rep. 499, and cases cited.

The judgment of the county court is affirmed.

§331. *Checks.*—The preceding case correctly states the rule regarding the position of an indorser of a check.

With respect to the drawer of a check it should be noted that he does not stand in all respects on the same footing with the drawer of a bill. The negligence of the holder in complying with the requirements of presentment and notice of dishonor does not absolutely discharge the drawer of a check, but discharges him only to the extent of the loss he has sustained thereby.

§332 *FAR ROCKAWAY BANK v. NORTON.*

Court of Appeals of New York, 1906. [186 *N. Y.* 484.]

Appeal from a judgment of the Appellate Division of the Supreme Court in the Second Judicial Department, entered January 8, 1906, affirming a judgment in favor of plaintiff entered upon the report of a referee.

The nature of the action and the facts, so far as material, are stated in the opinion.

CULLEN, C. J.: The action is brought on a promissory note made by one Smith to the plaintiff, which the defendant indorsed prior to its delivery to the payee. But two questions are presented on this appeal:

First. It is alleged the referee committed error in excluding evidence offered by the defendant to show that Smith, the maker, had, some time subsequent to the maturity of the note, a sufficient deposit in the plaintiff bank to pay it, which the plaintiff failed to appropriate for that purpose. The case of *National Bank of Newburgh v. Smith*, 66 N. Y. 271, 23 Am. Rep. 48, is a conclusive authority to the effect that, in the absence of any direction or agreement to that effect, it was optional with the plaintiff whether it would apply the money or not upon the note in suit, and that it was under no positive legal obligation to do so. Therefore there was no error committed in this respect.

Second. The note was given in renewal and to take up an earlier note, also indorsed by the defendant. To establish the fact that the defendant had indorsed the note with the purpose of giving the maker credit with the payee, proof was given tending to show that, default having been made in the payment of the earlier note, notice of protest thereof was given to the defendant. It is urged that the evidence as to the protest of the earlier note was not of a proper character. It is unnecessary to consider this question, for since the enactment of the Negotiable Instruments Law (Laws 1897, p. 719, c. 612) the law obtaining in the case of such indorsement as that made by the defendant has been radically changed. Prior to that time the indorser was presumed to be a second indorser, and not liable to the payee, though it was competent for the payee to prove *aliunde* that the intention of the indorser was to give the maker credit with the payee. *Bacon v. Burnham*, 37 N. Y. 614; *Coulter v. Richmond*, 59 N. Y. 478. Section 114 of the Negotiable Instruments Law prescribes a different rule. It is enacted that "where a person, not otherwise a party to an instrument, places thereon his signature in blank before delivery, he is liable as indorser in accordance with the following rules: (1) If the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties." This note was made in December, 1898, and therefore the proof offered by the plaintiff was not necessary to maintain its cause of action, and the error, if error there was, was immaterial.

The judgment appeal should be affirmed, with costs.

§333 *THOMPSON v. CURRY, et al.*

Supreme Court of Appeals of West Virginia, 1917.

[79 *W. Va.* 271.]

LYNCH, P.: . . . The uncertain status of an irregular or anomalous indorser at the common law, as interpreted by the courts of the different jurisdictions was, as generally agreed, one of the chief inducements for the movement that culminated in the adoption of the Uniform Negotiable Instruments Law by many of the states of the Union. The varied interpretation of the relation that an indorsement in blank created, as between the apparent makers, indorsers and others, during the course of the instrument, operated as an impediment or obstruction to its commercial circulation and currency. For, if as held in this state in the case cited, the payee or indorsee of such paper had the option to treat as a joint maker, guarantor or indorser one who signed his name in blank on the back thereof, his status was one of doubt and uncertainty wherever the paper found its way in commercial transactions, because other jurisdictions gave him a different status. 3 R. C. L. §§340-347; 8 C. J. §118 *et seq.*

Giving to §§63 and 64, c. 98A Code, their logical and legitimate interpretation and effect, in view of the purpose of the whole act, the conclusion seems to be inevitable that where, before delivery to the payee, a person signs his name in blank on the back of the instrument in form negotiable, otherwise than for the purpose of transferring the title, he is to be deemed as having consented to be bound in the capacity of an indorser and not otherwise, although under the common-law rules his status may have been different. These sections fix and determine the exact relation he bears to the paper, when it passes by delivery to the payee; a relation that remains fixed and stable during the entire circulation of the instrument. Until it is paid, he occupies the position of an indorser, and, as such, is subject to the burdens imposed by that relation, and entitled to whatever protection it affords. That relation, its burdens and immunities, are the same in all jurisdictions wherein the Uniform Negotiable Instruments Act has been enacted and now is in force. His liability is no longer susceptible of doubt or uncertainty. The statute fixes his status, a status wholly beyond the power of alteration or change at the option of the payee or any subsequent holder. Such indeed is, with one exception, the concensus of opinion, so far as expressed by authors and decisions dealing with the new form of legislation.

§334 *DUMONT v. WILLIAMSON.*

Supreme Court of Ohio, 1869. [18 *Ohio St.* 515.]

SCOTT, J.: The original action in this case was brought by the plaintiff in error, who states in his petition "that Henry Essman, on the 12th of May, 1860, at Cincinnati, made his promissory note in writing of that date, and thereby promised to pay to the order of William Wolff five hundred dollars, for value received, in four months after the date thereof, and which said promissory note purports to be indorsed on the back thereof by William Wolff, which said note afterward came to the hands of the defendant, who afterward then and there indorsed and delivered the same to the plaintiff, but without recourse on him. The plaintiff avers that the defendant did thereby warrant that the indorsement on the back thereof was the signature of William Wolff, and was made by him, whereas in truth and in fact said signature on the back of said note was not made by said William Wolff, but was and is a forgery, and by reason thereof said note was wholly worthless, and of no value, the said Henry Essman, the maker thereof, being wholly insolvent."

The petition proceeds to allege due demand and notice of non-payment at maturity, and asks judgment for the amount of the note, with interest.

A copy of the note is attached to the petition, which, with the indorsement thereon, corresponds with the statements of the petition.

To this petition the defendant demurred, and the case was thereupon reserved from special term for the opinion of the judges in general term upon the questions of law arising on the demurrer. By the judgment of the court in general term the demurrer was sustained, and the plaintiff not desiring to amend his petition, it was thereupon dismissed, and judgment rendered against plaintiff for costs.

The plaintiff here asks a reversal of this judgment on the ground of error in the Superior Court in sustaining the demurrer to his petition.

There is no statement in the petition of the circumstances under which the note in this case was transferred to the plaintiff, or the consideration paid therefor, but it is to be presumed that it was so transferred for a valuable consideration. If the fact be otherwise, this is a matter of defense, to be set up by answer.

There is no averment of fraud, or that the defendant had knowledge at the time of the transfer, of any defect in the note, which he concealed. The question therefore arises, whether

upon the sale and transfer of a promissory note by indorsement, "without recourse," the vendor impliedly warrants that the signatures of the prior parties whose names appear thereon are genuine.

Whilst the words "without recourse," accompanying an indorsement, clearly indicate that the party making the transfer does not intend to assume the position of an unconditional indorser, or to incur any liability if the note is not paid at maturity, upon due demand, or even if all the parties to the paper should prove to be wholly insolvent, we think they can not be construed as importing more than this. At least they do not divest such indorser of his character as a vendor of the note, nor exempt him from the liabilities arising from a sale and transfer by delivery, where the note is capable of being thus transferred. In such case, then, is there no implied warranty on the part of the vendor that the note is not forged? That it is in fact what it purports on its face to be?

On this question the language of the text-books, in this country at least, is nearly, if not quite, uniform.

Justice Story, in his *Commentary on Promissory Notes,* §118, speaking of the liabilities of a party who transfers a note by delivery only, says: "In the first place he warrants by implication, unless otherwise agreed, that he is a lawful holder, and has a just and valid title to the instrument, and a right to transfer it by delivery; for this is implied as an obligation of good faith. In the next place, he warrants, in like manner, that the instrument is genuine, and not forged or fictitious." To this the editor of the fourth edition of the work, published in 1856, adds in brackets: ["that it is of the kind and description it purports on its face to be; unless where the note is sold, as other goods and effects, by delivery merely, without indorsement, in which case it has been decided that the law respecting the sale of goods is applicable, and that there is no implied warranty;"] referring in the notes to the cases of *Baxter v. Duren,* 29 Maine R., 434; *Ellis v. Wild,* 6 Mass. R., 321, and other authorities, also to conflicting decisions. This new matter was added to the text after Justice Story's death, as is shown by the brackets, and was evidently intended only as a statement of the authorities bearing on the question. The exception stated to the general rule as laid down by Judge Story cannot, therefore, claim the sanction of his name.

The law is similarly stated in Parson on *Notes and Bills,* Vol. 2, pages 37, 39, where it is said to be "well settled that the vendor without indorsement [the Transferrer] warrants that the paper is of the kind and description that it purports to

be.'' In a note on page 38, the case of *Baxter v. Duren, supra,* is referred to, where it was held that one who sells and transfers a promissory note by delivery is not liable on an implied warranty of its genuineness, if he sold the same as property, and not in payment of a debt previously existing or then created, and if he did not know of the forgery. But it was said in that case that if the note was transferred by delivery merely, in payment of a debt due, or for goods then purchased, or by way of discount for money then loaned, there would in such case be an implied warranty of the genuineness of the paper. ''But,'' adds the learned author, ''this distinction does not seem to be well founded.'' And again, at page 589 of the same volume, the principle is broadly stated ''that any transferrer of a note or bill transferable by delivery, warrants that it is no forgery. If it turns out that the name of one of the parties is forged, and the bill becomes valueless, the vendor, though no party to the bill, becomes liable to the vendee as upon failure of consideration.'' He then proceeds to state, without further comment, the distinction which was taken in the case of *Baxter v. Duren, supra,* and of which he had previously disapproved.

So, in Edwards on *Bills and Promissory Notes,* page 291, it is said: ''The party assuming to transfer a negotiable instrument thereby asserts it to be genuine, and is bound to make his assertion good.'' And on page 289: ''Though the indorser transfers the note upon condition that it is to be collected at the risk of the indorsee, he is nevertheless responsible if the note proves to be a forgery. *Shaver v. Ehle,* 16 Johns. R., 201, and 20 N. Y. R., 226.

In England, it seems to be well settled by the latest decisions on the subject, that the vendor of a bill of exchange is responsible for its genuineness. Thus, in *Gompertz v. Bartlett,* decided in 1853, it was held by the Court of Queen's Bench that the vendor of a bill of exchange impliedly warrants that it is of the kind and description that it purports on the face of it to be. 24 Eng. L. and E. Rep., 156; 23 L. J. Ex., 65; see also *Challis v. McGrum,* 22 Kan. 157; *Bell v. Dagg,* 60 N. Y., 528; *Bell v. Cafferty,* 21 Ind., 411. And in *Gurney and others v. Womersley,* 24 L. J., Q. B., 46, decided in 1854 by the same court, it was held that the vendor of a bill of exchange, though no party to the bill, is responsible for its genuineness; and if it turns out that the name of one of the parties is forged, and the bill becomes valueless, he is liable to the vendee, as upon a failure of consideration. Both these cases were decided on the

same principle which is applied in sales of personal property generally, that the vendor impliedly warrants that the article sold is of the kind and description which it imports and is understood by the parties to be.

In the case of *Baxter v. Duren,* 29 Me., 434, *supra,* it was held that one who sells a promissory note, by delivery, upon which the names of indorsers have been forged, is not liable upon an implied promise to refund the money received therefor, if he sold the same as property, and not in payment of a precedent debt, and did not know of the forgery.

The same doctrine was held in the case of *Ellis v. Wild,* 6 Mass., 321, where the same distinction was made between the sale of the note and its transfer in payment of a debt. But the doctrine is no longer maintained in that commonwealth. *Cabot Bank v. Morton,* 4 Gray, 156; *Lobdell v. Baker,* 1 Met., 193; *Merriam v. Wolcott,* 3 Allen, 258. In the last of these cases, *Ellis v. Wild* and *Baxter v. Duren* are both considered, and, for what seems to us good reasons, disapproved; and it is held that there is no valid reason for the distinction taken in those cases.

In *Aldrich v. Jackson,* 5 R. I., 218, the doctrine is expressly stated that "the vendor of a bill or note, by the very act of sale, impliedly warrants the genuineness of the signatures of the previous parties to it."

The same doctrine is held in *Terry v. Bissel,* 26 Conn., 23, and in *Thrall v. Newell,* 19 Vt., 202.

And the principle upon which these decisions rest has its foundation, as we think, in reason and justice.

In the sale of what purports to be a promissory note, it is not the material substance of the paper and ink for which the consideration is understood by the parties to be paid, but it is the chose in action of which the note purports to be the evidence, that is the real subject of negotiation and transfer. But if the note is forged, if no such chose in action exists, if the vendor neither owns nor parts with anything of the kind, it is difficult to see any just ground upon which he can be allowed to retain the purchase money. He has undertaken to sell what he did not own, and that which in fact has no existence. The maxim of *caveat emptor* is inapplicable to such a case.

The present case, however, is much stronger. It is not a case of sale by delivery merely, but by indorsement, qualified, it is true, so as to exclude the liabilities consequent thereon under the commercial law. Still, the defendant is a party to

the note, he has sold and transferred it as such, and he is bound to make his representation good. On this question we know of no conflict of authorities.

The judgment of the court below must then be reversed, the demurrer to the plaintiff's petition overruled, and a *procedendo* awarded.

§335. *Warranties in Negotiable Instruments.*—"The modern law of bills and notes, as well as other branches of commercial law, is a product of the interplay of mercantile custom and common law principle."[1] One illustration of this is found in the warranties incident to the transfer of negotiable instruments. Besides the liability incurred by virtue of the law merchant, there is involved in negotiation by indorsement an agreement of warranty based on the general principles of warranty as developed in the common-law rules as to sales. A negotiable instrument, besides being a negotiable instrument, is evidence of a *chose in action;* that is to say, a right to enforce a contractual obligation in court. And even when the indorsement is made "without recourse," there is an "implied warranty" that the thing sold is what it purports to be. The provision of the Negotiable Instruments Law (Sec. 65) is as follows: "Every person negotiating an instrument by delivery or by a qualified indorsement [as when there is added to the indorser's signature the words "without recourse" or any words of similar import], warrants

> 1. That the instrument is genuine and in all respects what it purports to be;
> 2. That he has a good title to it;
> 3. That all prior parties had capacity to contract;
> 4. That he has no knowledge of any fact which would impair the validity of the instrument or render it valueless.
>
> But when the negotiation is by delivery only, the warranty extends in favor of no holder other than the immediate transferee.
>
> The provisions of subdivision three of this section do not apply to persons negotiating public or corporation securities, other than bills and notes.

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[1]Street, *Foundations of Legal Liability,* vol. 2, p. 409.

§336 *WILLIAMS, DEACON & CO. v. SHADBOLT.*

Queen's Bench Division, 1885. [1 *Cab. & El.* 529.]

This was an action on bills of exchange by indorsees against the acceptors.

The Dana Land & Lumber Company carried on business in Mobile, Alabama, United States, and consigned timber from time to time to the defendants, timber merchants and agents in London. The course of business was for the Dana Company to draw on the defendants from time to time, not against particular shipments, but for amounts regulated by the quantity of timber in course of shipment. These drafts the Dana Company used to discount with the Bank of Mobile, at Mobile; and the Bank of Mobile forwarded them to the plaintiffs in London indorsed restrictively in the manner the bill hereinafter set out was indorsed. The plaintiffs on receiving the draft would take it to the defendants for acceptance, and the plaintiffs thereupon credited the Mobile Bank with the amount of the draft, and allowed them to draw on them at once against the amount so credited. The acceptances would then, in the ordinary course, be paid by the defendants to the plaintiffs at maturity. The defendants were not aware that the plaintiffs used to allow the Bank of Mobile to draw against the amount of the acceptances before maturity.

In pursuance of the above course of business the Dana Company drew bills upon the defendants in a form of which the following is a sample:

> "Sixty days after sight of this first of exchange (second and third unpaid), pay to the order of ourselves £1,600 sterling value received, and charge the same to account of as advised.
>
> "Dana Land and Lumber Company.
>
> "To Messrs. Geo. Shadbolt & Son, London."

This draft with others was discounted by the Dana Company with the Bank of Mobile, and indorsed to the bank. The bank indorsed the drafts to the plaintiffs as follows:

> "Pay to the order of Messrs. Williams, Deacon & Co., for collection per account of the Bank of Mobile, Mobile, Alabama.
>
> "A. F. Manley, Cashier."

The plaintiffs presented the drafts to the defendants for acceptance, and the defendants accepted the same. The plaintiffs thereupon allowed the Bank of Mobile to draw on them for the amount of the said bills.

Before the bills matured, the Dana Company paid to the Bank of Mobile the amount of the bills, and wrote to the defendants releasing them from their liability as acceptors.

The defendants never received any assignments of timber on account of these bills.

Subsequently both the Dana Company and the Bank of Mobile failed.

CAVE, J.: The question is what is the effect of a bill being restrictively endorsed? Section 35 of the Bills of Exchange Act, 1882, defines a restrictive indorsement as one which prohibits the further negotiation of the bill, or which expresses that it is a mere authority to deal with the bill as thereby directed, and not a transfer of the ownership thereof. We have therefore in this case an indorsement which is not a transfer of the ownership of the bill, but merely operates as an authority to the indorsee to receive the money on behalf of the indorser. This kind of indorsement was well known long before the act of 1882. In *Lloyd v. Sigourney*, 5 Bingham, 525, the bankers of the person to whom the bill was restrictively indorsed discounted the bill for their customer, and allowed him to apply the proceeds for his own use; and it was held that the bankers were liable for that amount to the indorser. Best, C. J., there says: "Whoever reads the indorsement on this bill of exchange must perceive that its operation is limited, and that the object of the indorser was to prevent the money received in respect of the bill from being applied to the use of any other person than himself. To whomsoever the money might be paid, it would be paid in trust for the indorser; and into whose hands soever the bill traveled, it carried that trust on the face of it. And we see no inconvenience to commercial interests from such a limitation of the effect of the indorsement so expressed. The only result will be to make parties open their eyes, and read before they discount." Those observations are eminently applicable in this case. The indorsee had authority to collect the amount of the bill; but the ownership of the bill and of the debt remained in the Bank of Mobile, and the payment to that bank was a perfectly good payment. That it is a good payment is perfectly clear, unless the course of business between the plaintiffs and the Bank of Mobile makes a difference; for the appointment of an agent to receive a debt does not prevent the payment of the debt to the real creditor. Can, then, the arrangement between the plaintiffs and the Bank of Mobile, that the latter shall draw on the former for the amount of the acceptances, affect the rights of the parties to the bill, and alter the quality of the indorsement? Can it be that if the Bank of Mobile does not

draw against an acceptance, the defendants can pay the amount of the acceptance to the Bank of Mobile; but if the Bank of Mobile does draw, then the defendants can only legally pay the plaintiffs, and this, though the defendants know nothing about the arrangement between the plaintiffs and the Bank of Mobile? Again, if the property in the bill passes to the plaintiffs, when does it pass? Clearly not at the time of the indorsement. Does it pass, then, at the time the advance is made by the plaintiffs? This would be subsequent to the indorsement and delivery of the bill; and so the property in the bill would pass without indorsement or delivery. In my opinion the plaintiffs never got any property in the bill. They got merely an expectation that the money would be paid by the defendants, but were never owners of the bill. The plaintiffs' right of action is against the Bank of Mobile, and not against the defendants. As against the defendants, they cannot assert rights in respect of the bill which their indorsers, the Bank of Mobile, cannot assert; and it is clear that the Bank of Mobile have no cause of action against the defendants.

I do not think this decision can produce any mischief or inconvenience. As Chief Justice Best says: "Parties must open their eyes and read before they discount."

If the plaintiffs desire to secure themselves in the course of business they have adopted, they should insist upon a general indorsement, and not take a restrictive one. A restrictive indorsement has been long used for the very purpose of preventing the property in the bill from passing, and its effect as so doing has now been sanctioned by the Legislature; and it would be very dangerous to hold that, by reason of a secret arrangement between indorser and indorsee, a title can be conferred, and the property pass, and so the rights of the acceptor be affected, without his knowledge.

Judgment for the defendants. . . .

§337. *Restrictive Indorsements.*—The provisions of the Negotiable Instruments Law with respect to restrictive indorsements are as follows:

Section 36. An indorsement is restrictive, which either:

(1) Prohibits the further negotiation of the instrument; or

(2) Constitutes the indorsee the agent of the indorser; or

(3) Vests the title in the indorsee in trust for or to the use of some other person.

But the mere absence of words implying power to negotiate does not make an indorsement restrictive.

Section 37. A restrictive indorsement confers upon the indorsee the right:

(1) To receive payment of the instrument;

(2) To bring any action thereon that the indorser could bring;

(3) To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so.

But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement.

§338. *Defenses.*—An understanding of the subject of defenses to negotiable instruments requires an understanding of the distinction between negotiation and assignment. It must be borne in mind that the very idea of the transfer of the *chose in action* represented by the bill or note was, a hundred years ago, almost as anomalous as negotiation, for *choses in action* were not assignable at law. Equity recognized the assignee, it is true, to the extent of empowering him to make the assignor lend his name to a proceeding to enforce the *chose in action* for the benefit of the assignee. It is thus not strictly true that a negotiable instrument shorn of its negotiability, for example, by having matured, was a mere *chose in action,* although today it is very much like one, since the assignability of these *choses in action* is, in effect, though not in so many words, recognized by law.

But negotiability is something more than assignability, in that it involves the power of making a transfer which "cuts off equities." It gives a title, in other words, only partly based on transfer, and partly based on a kind of original acquisition which business custom recognized as proper or even essential, and in which the law has acquiesced. To take a concrete example of the difference between assignment and negotiation: If A buys goods from B and is charged for them on ordinary book account, B's claim can never grow any stronger by assignment to a purchaser, even assuming that the law will recognize the assignment. If A, for example, has a partial defense against B, based on a defect in the goods, A can set up that defense against any one else who proceeds against him as B's representative or suc-

cessor. On the other hand, let us assume that A has given B a promissory negotiable note as evidence of his indebtedness. In the hands of B this note is subject to all the defenses and defects to which the book account is subject, excepting, of course, that the evidence against A is a little clearer on its face. If, however, B endorses the note to C before maturity, for value and without notice of the defect in B's claim, A when sued by B cannot set up this defect. C gets the instrument by negotiation, free from all so-called "equities" and A's only remedy, so far as the defect is concerned, is in a separate action against B.

It is a common error to suppose that the *bona fide* purchaser of non-negotiable *choses in action* or even of things, stands in an advantageous position in the eyes of the law. This is not generally true. The doctrine of *caveat emptor* (let the buyer beware) applies. There are a few apparent exceptions, but they are quite distinct from negotiability. Thus if the seller's title is voidable for fraud, the title of the *bona fide* purchaser for value without notice is indefeasible. Again if the sale constitutes a breach of trust, the *bona fide* purchaser's title is not affected by the trust. Under recording acts, an unrecorded claim can not be used against a *bona fide* purchaser of the property. In all of these cases the interest served, security of transactions, is very much like the interest served by negotiability, and the effect is the same in some cases, but the business effect is quite different. One cannot feel the same freedom from *caveat emptor* in dealing with horses or any other kind of property that he can in dealing with negotiable instruments.

On the other hand, recent statutes in many states have aimed at making certain business documents if drawn to "bearer" or "order" truly negotiable. Among these documents are warehouse receipts, bills of lading and certificates of stock.

§339 *CLARK v. PEASE.*

Supreme Judicial Court of New Hampshire, 1860.

[41 *N. H.* 414.]

Action by indorsee against maker on a promissory note. Defenses: duress by imprisonment; illegality because given to compromise a crime. The defendant offered evidence to substantiate the defenses.

The plaintiff excepted to this evidence, as no defense against the indorsee, without proof that he was not the *bona fide* holder of the note. But the court ruled that if the note was obtained by duress, it was void in the hands of an innocent indorsee, and thereupon the plaintiff, admitting for the purposes of this trial that the defendant's witnesses would testify to the facts stated, a verdict for the defendant was taken by consent, subject to the opinion of the court; and the questions thus raised were reserved, and assigned to the determination of the whole court.

SARGENT, J.: That the case presented is clearly one of duress there can be no question. The abuse of any process, either civil or criminal, to compel a party, by imprisonment, to do any act against his will except to pay the debt for which he is arrested, is entirely illegal, and the act may be avoided on the ground of duress. (*Richardson v. Duncan,* 3 N. H. 508; *Severance v. Kimball,* 8 N. H. 386; *Shaw v. Spooner,* 9 N. H. 197; *Burnham v. Spooner,* 10 N. H. 523; *Breck v. Blanchard,* 22 N. H. 303.) Here the arrest was without any warrant or lawful authority. Such duress is a perfect defense, upon all the authorities, to an action between the original parties.

The note in this case was not only void as between the original parties, on the ground of duress, but was given to compromise a charge of crime, and was wholly illegal upon that ground. (*Plumer v. Smith,* 5 N. H. 553.)

But the principal question raised here by the ruling of the court is, whether such a note is absolutely void in the hands of any holder; and if not, then another question arises upon the exception which was taken by the plaintiff, which is this: After an indorsee has made out a *prima facie* case by proving the indorsement, etc., and the defendant has shown that the note was obtained from him by duress, upon whom rests the burden of proof? Must the defendant prove that the plaintiff was not the *bona fide* holder, and that he did not pay a valid consideration for it, as the plaintiff claimed? or, the duress being proved, does that throw the burden of proof upon the plaintiff, to prove how he came by the note, and the consideration he paid, etc., as the defendant claims? We will examine these questions in the order in which we have stated them.

1. Is this note absolutely void in the hands of any holder, however innocent, who has paid a valid consideration for it before it was due?

(The court here discusses the grounds for avoiding contracts generally.)

Now bills and notes stand upon the same foundation as all other contracts do, in all the above respects, so long as they

remain in the hands of the original payee. But bills and notes have another attribute, which other contracts ordinarily do not possess—that is, negotiability. Where a bill or note has been negotiated, and passed into the hands of a *bona fide* holder before it is due, and for a valuable consideration, in such case the holder acquires rights which did not belong to the payee. He stands in a different relation to the promisor. These additional rights and privileges have been conferred upon such holder by law, for good and sufficient reasons, too well known and understood to need to be stated, but which are incident to, and dependent upon, the attribute of negotiability, which these instruments possess.

And it may be laid down as the general rule, as the general principle applying to this class of cases, that such a note, thus negotiated and in the hands of such a holder, is not liable to any defense which the maker had as against the original payee. To this general rules there are some exceptions, among which are:

1. When a statute not only prohibits the making of a contract, but provides that the same shall be void to all intents and purposes; or where the law provides that any contract made or securities given upon any illegal consideration shall be absolutely void, then the note which embodies such contract, or is based upon such consideration, is held void everywhere and in the hands of every holder. In England, and in most of the United States, there are or have been laws against usury, which not only, by a general prohibition of usury, made that an illegal consideration for a note, but also provided that all bills or notes founded upon such a consideration should be absolutely void. Such, however, is not the law in this state on that subject, and it is believed that we have no statutes with similar provisions. Hence, here usury may be a good defense to a note as against the original party, but not as against an innocent indorsee, for value, etc.

2. When the note is a forgery, it is void everywhere.

3. When the maker belongs to a class of persons who are ordinarily, and as a general rule, on grounds of public policy, held incompetent to contract at all, such as infants, married women, alien enemies, and insane persons, including spendthrifts and others under guardianship, who have been by some statute declared incompetent to contract.

4. Notes signed by agents without authority.

In none of these cases (except the first, which, as we have seen, does not apply in this state), is a note valid in the hands of anyone; and the party who discounts such paper is bound

to inquire, at his peril, whether the note offered to him is signed by a party capable and competent in law to bind himself, or by an agent duly authorized to bind his principal. Besides this, he is bound to inquire whether the party from whom he receives it is competent to make such transfer in his own right, or is authorized to do it for his principal, for whom he assumes to act.

If there is a failure in either of these points of capacity or authority, it will not avail the party that he is a *bona fide* holder, for value, without notice. He must look to his indorser if he has one, and if he has not he must suffer loss.

5. Another case might be mentioned, which has been made an exception to the general rule above stated by express provisions of the statute—as where a note is attached by the trustee process. There, by operation of the statute, the maker of a note may have a perfect defense against an indorsee, for value, without notice, and before due. So notes discharged by operation of insolvent laws might afterwards be transferred, by possibility, so as to form another exception, where the indorsee, holding the note *bona fide,* etc., might be met with a perfect defense on the part of the maker. But these last cases throw no light upon the question we are considering.

These are the principal, perhaps all the exceptions to the general rule stated above, that no defense is available against an innocent indorsee, for value paid before due. But where the contract was illegal, being prohibited by law, or the consideration was illegal, as usury, wagers, compounding a felony, restraint of trade or of marriage, etc., or where there was a want or failure of consideration, and even where the note has been paid—all these defenses, and many more, cannot be made against the note in the hands of such a holder. And the question here raised is, whether, in case of duress, or fraud, where there is *mala fides,* but it is all on one side, and the other party to the note has been induced to sign it by force or by fraud, and is in every respect an innocent party, such defense shall avail him as against such a holder, for value, etc., who seeks to collect it.

And we think such a defense cannot avail the maker against such an indorsee of the note. The authorities favor this view. . . .

Suppose an individual, then, were about to purchase a note payable to bearer, before it was due, and pay a fair equivalent for it, with a view of collecting it of the maker, and where he is to have no indorser to rely upon—what would be his duty in order to proceed safely? First, he must assure himself of the

genuineness of the signature, or, if it purported to be signed by an agent, he must assure himself that the agent was duly authorized to bind his principal in that particular; secondly, he must make such inquiries, which, ordinarily, he may easily do, as to ascertain that the signer is not an infant, a married woman, an alien enemy, an insane person, etc., that he does not belong to a class of persons who are always presumed by the law to be incompetent to contract; and thirdly, he might need, for his own safety, to inquire whether the signer of the note had been trusteed, or whether any other special statute could affect his claim to it. When he has satisfied himself upon these points, if he learns of no other defects, and the signer is of sufficient ability to respond, he may purchase; and there is generally very little trouble in ascertaining these facts. They are usually matters of public notoriety, about which there can be little room for mistake.

But, suppose that after being satisfied upon all these points, and having purchased the note, it should prove that it was an illegal contract, or was for an illegal consideration—who shall suffer?—the maker or the indorsee? This is settled on the best of authority. The original parties stood upon equal ground, both being in fault, and could neither of them enforce the contract; yet neither shall be allowed to take advantage of his own wrong as against an innocent indorsee.

And suppose it should turn out that his note was obtained of the maker by fraud or by duress, a case in which the maker was in no fault—what rule shall be applied here?—the long established one, that where one of two innocent persons must suffer, the loss should fall upon him who has suffered a negotiable security, with his name attached to it, to get into circulation, and thereby mislead the indorsee. Such rules, and such an application of them, are necessary to give security to negotiable paper. . . .

The exception to the ruling of the court upon this point must be sustained; but we shall find that the numerous authorities which bear upon the next question to be considered have also a direct bearing upon this point.

II. Next let us inquire, upon whom is the burden of proof after duress, or fraud, or illegality of consideration is proved? Must the defendant not only prove that he had a perfect defense to the note originally, but also show that the indorsee had notice of the defect, or that he paid no consideration for it, or that he is not in some way the *bona fide* holder of the note? Or must the plaintiff, after such defense to the original contract is proved, assume the burden of proving that he is a *bona fide*

holder, for a valuable consideration, without notice of any defect, and that it came seasonably into his hands?

(After discussing various authorities.)

These authorities would seem conclusive, that the plaintiff's exception—that the evidence offered would have been no defense unless it were proved that he was not the *bona fide* holder—must be overruled. When the defendant had proved the duress, he had made a good defense as against the original party; and because of the legal presumption that in such cases the payee, being guilty of such illegality, would dispose of the note and place it in the hands of some other person to sue upon it, he had thereby cast a suspicion on the plaintiff's title, which threw the burden upon him of showing affirmatively that he was a *bona fide* holder for value. Nor can we see that the fact that this evidence was offered under the general issue alters the position of the parties or the state of the case.

These authorities also bear directly upon the first point taken by the defendant, that duress is a defense against any holder, however innocent he may be, and however valuable a consideration he may have paid for the note; and if other authorities on this point were needed, they are not wanting. In *Cowers v. Ball* (27 Vt. 662), Redfield, C. J., says: "Illegality, duress, fraud, and want or failure of consideration, are no defense as against a *bona fide* holder for value." (See, also, *St. Albans Bank v. Dillon,* 30 Vt. 122; *Ellicott v. Martin,* 6 Md. 509; *Minell v. Reed,* 26 Ala. 730; *Norris v. Langley,* 19 N. H. 423; *Knight v. Pugh,* 4 Watts & Serg. 445.)

The verdict must be set aside, and a new trial granted.

§340. *Absolute and Personal Defenses Distinguished.*—The provisions of the Negotiable Instruments Law with regard to defenses which are not available against a holder in due course are contained in §57 which reads as follows: "A holder in due course holds the instrument free from any defect of title of prior parties, and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon."

Professor Williston in his monumental treatise on *Contracts,* comments as follows (§§1158 and 1159):

"The statute does not mark out, as clearly as it might, the sharp distinction between absolute and personal defenses; though unquestionably, under the statute as before its enactment, the

law distinguished between a situation where there is only apparently but not really a negotiable obligation, and a case where there is an actual negotiable obligation but for some equitable or personal reason it should not be enforced. If the signature of a maker to a negotiable instrument is forged, though he has apparently entered into a negotiable obligation, in fact he has not, if, however, he has been induced by fraudulent misstatements to sign such an instrument, he has actually entered into a negotiable obligation, though it is unjust to enforce it in favor of the fraudulent payee. On the forged note nobody can recover against the apparent maker. On the fraudulent note the payee, if a party to the fraud, could not recover, but a holder in due course could. It may then be said that forgery is an absolute or real defense while such fraud as that given in the illustration is a personal or equitable defense, or, briefly, an equity. No equitable defence is available against a holder in due course. This distinction between absolute or real defenses on the one hand and personal defenses or equities on the other hand, is fundamental in the law of negotiable instruments. All the defenses in question, whether absolute or personal, would be available in case of non-negotiable contracts, and, therefore, in regard to such contracts, there is not the same importance in distinguishing the two classes of defenses. Though most of these defenses are dealt with in other parts of this book with reference to their application to contracts generally, yet they may conveniently be summarized here. Prior to the enactment of the Negotiable Instruments Law, the following defenses to an obligation were absolute or real, and still remain so unless §57 of the Act requires a different result:

> First—The lack of genuineness of the signature. This may be due to forgery or it may be due to lack of authority on the part of an agent who made the signature on behalf of another;
>
> Second—Some kinds of fraud and duress;
>
> Third—Lack of title, as where a holder claims through a forged indorsement;
>
> Fourth—Bankruptcy of the holder;
>
> Fifth—Legal incapacity as of a minor, an insane per-

son, and in some jurisdictions as to some matters—a married woman;

Sixth—Illegality of certain kinds;

Seventh—The legal discharge of the instrument or the obligation in question.

The following are personal defenses, or equities only, and are not available against a holder in due course:

First—Illegality of certain kinds;

Second—Fraud or duress generally;

Third—Lack of delivery of the instrument;

Fourth—Lack of consideration;

Fifth—Failure of consideration;

Sixth—Alteration;

Seventh—Discharge of the instrument before maturity;

Eighth—A surety is discharged by certain dealings with his principal which are prejudicial to him;

Ninth—Set-off.

"There may be a defense to one obligation on a negotiable instrument and no defense to another on the same instrument. Sometimes all the obligations on an instrument are subject to the same defense, as where the instrument is materially altered after all the signatures have been put upon it. Sometimes there may be a defense of one kind to one obligation on the instrument, and a defense of another kind to another obligation. The obligation of each person whose name appears on the instrument frequently must be considered separately.

"The words 'Defect of title' in this section even when aided by §55 and by the definition of holder do not indicate with perfect clearness that it is only personal or equitable defenses from which the holder is freed, but there was probably no intention to change the law in regard to the matter, and there is no reason to suppose that a change has been effected. Therefore, though in some cases a purchaser of an instrument payable to bearer can enforce it even though by common law or statute the instrument was originally void, yet where the instrument was originally void, and there are either no circumstances justifying an estoppel, or, though there are, the policy of the law

forbids enforcement of the instrument even by a holder in due course, such a holder, according to the better view, cannot recover under the statute any more than under the previously prevailing law. There are, however, decisions which lay stress on the words of the statute as showing that such illegality as formerly subjected a note to an absolute defense now affords merely a personal one.

"Section 57 changes the law of some states by allowing (as it properly should) a holder in due course to recover the full amount of a note subject to an equitable defense, though the holder bought it at a discount."

PART IV

THE LAW OF BUSINESS ORGANIZATION

CHAPTER XI

NATURE AND FORMATION OF THE RELATIONS INVOLVED

A. In General

§341. *Historical Note on Business Organization and the Law.* —To understand the modern law of business organization it is necessary to bear in mind that it owes its origin to an attempt on the part of courts to decide controversies of a very modern kind on the basis of such precedents as they happened to have at hand. When the English law, on which ours is based, became crystallized, business organization in the modern sense was, of course, non-existent. Even a hundred years ago the analogy readiest at hand for the ordering of the internal affairs of a business concern was the organization of the household. It is, therefore, no mere accident that law books until recently insisted upon dealing with the subject of Master and Servant as a branch of domestic relations. In fact, the very terms "master and servant" are primarily descriptive of a domestic rather than a business relation. It was a characteristic of the system of apprenticeship that the business unit and the household unit were identical; the master was simply the head of the household.

In course of time, the first analogies became less and less applicable to the acutal conditions of business life. Other analogies were called in. In the nineteenth century the dominant idea with which courts met new conditions was the idea of Contract. Indeed, in the middle of the century, Theophilus Parsons made the extreme statement at the opening of his comprehensive work on *Contracts* that all law could be reduced by analysis to contract law. A little later, Sir Henry Maine gave

wide currency to the notion that the progress of all civilized societies had been from Status to Contract. The idea was seized upon by political philosophers as well as lawyers, and somehow contract came to be looked upon as an instrument of freedom. These doctrines are no longer held today in their unmodified form, but they have left their impress on such business law, including the law of business organizations, as was molded in the nineteenth century. Thus the conception of "master and servant" has given way to the contractual conception of "employer and employee," as the feudal conception of "landlord and tenant" has yielded to the contractual theory of "lessor and lessee." The modern words look to some type of contract, the employment agreement or the agreement of lease; the older words merely described a status or situation without reference to the manner in which it was created.

In all ventures in which large capital is required, some kind of organization of associates is necessary. The beginnings of partnership in continental Europe are by no means clear. In Roman law it was shaped on the analogy of the position of coheirs managing an estate together. The idea was developed by mediæval itinerant merchants and received into England from the law merchant very much as negotiable instruments law had been. Nevertheless, the present law of partnership in the Anglo-American system contains a stronger admixture of common-law principles, particularly the common-law doctrines of joint ownership and joint obligations. Because of the influence of the latter conceptions the courts quite naturally refused to recognize the partnership itself as an entity distinct from the persons composing it. More recently, corporations have furnished the most vital type of business organization. Here we have the separate entity of the business organization recognized, and innumerable contracts and possible contracts among those who have an interest in the organization taken care of, by general provisions in the statutes. For the analogy on the basis of which the law relating to business corporations has been built up by courts and legislatures we must go back to those semi-governmental corporations which were chartered at the beginning of the sixteenth century

and of which the East India Company and the several American colonization companies are the best known examples. Thus corporation law is an attempt to apply to business needs quasi-governmental ideas.

There are several other types of business organization made possible by special statutes or by a measure of judicial recognition of irregular associations. These appear generally as peculiar varieties of corporations or partnerships or are dealt with under the equitable head of trusteeship.

Thus in the matter of business organization, as in the fashioning of credit instruments, the law has brought together from many different sources a body of unco-ordinated rules from which it has analogized and which, in course of time, have grown into the modern law of business organization.

In dealing with any particular problem of business organization it is always a desirable preliminary, therefore, to see the business problems stripped of the legal verbiage which is a survival from the attempt to fit the new business situation into the older analogies, and then to consider the possible solutions that the law has to offer. For example, on the question of how the assets of an unsuccessful business enterprise are disposed of, it is important to compare what takes place when the unsuccessful venture was carried on by a sole trader with the very different results which flow from the enforced distribution of assets of a venture organized as a corporation or as a partnership or as a special, statutory type of partnership, and so on. The difference in the results is sometimes quite shocking, being frequently based entirely on the accident of the analogies with which the courts have worked and not on the actual needs of the business community. A study of the problems of business organization from this point of view will serve at the same time as a means of properly assorting and arranging the instrumentalities furnished or recognized by the law for particular ends, and also as a critique upon law by showing just how far the process of co-ordinating the more or less unrelated sources of this branch of the law has gone.

§342 *CENTRAL TRUST COMPANY OF NEW YORK v. BRIDGES.*

United States Circuit Court of Appeals, 1893. [16 *U. S. App.* 115.]

[BILL IN EQUITY for a receiver and intervening petitions to determine the priority of lien claimants and mortgagees. Decree for lien claimants.

The lien claimants contracted with one Eager, who had taken a contract to construct the railway against which the liens were filed. The trial court found that the lien claimants had no contract directly with the railway; that nothing was due Eager from the railway; but that Eager was the principal stockholder and the company merely another name under which he did business, and that therefore the lien claimants in contracting with Eager had contracted with the railway.]

TAFT, CIRCUIT JUDGE (after stating the facts and the provisions of the statute of Tennessee relating to liens): Under this law, the contractor must deal directly with the company to secure a lien for his work or material, or, if a sub-contractor, then he can have no lien on the railroad unless at the time that or after he serves notice of his claim upon the company, the company shall owe money to his principal on the contract which his sub-contract has helped to perform; and his lien is limited to the amount so due and owing to his principal. In other words, the security of the sub-contractor is the balance due the principal contractor from the company when the company receives notice of the sub-contractor's claim, and after notice is given the lien of the sub-contractor is transferred from the balance due on the contract to the corpus of the railroad, *pro tanto.* But if there is no balance due at the time of service of the notice, there can be no lien.

In the consideration of the liens adjudicated below, two questions, therefore, arise. First, did the lien claimant deal directly with the company, as principal contractor? Second, if the lien claimants were sub-contractors under Eager as principal contractor, was there any sum due Eager as such principal contractor from the Knoxville Southern Railroad Company after the company was notified by the sub-contractors of their intention to claim liens?

First. The theory upon which the master and the learned court below held that all the intervening petitioners dealt directly with the Knoxville Southern Railroad Company as principal contractors, was that Eager was an agent of the rail-

road company in making the contracts. One may be liable for the acts of another as his agent on one of two grounds: first, because by his conduct or statements he has held the other out as his agent; or, second, because he has actually conferred authority on the other to act as such. The master reported to the court below that in no case did Eager, under or in the name of the Knoxville Southern Railroad Company, make any contract with any one doing work or furnishing material for the road; that the men who contracted with Eager knew very little of Eager, saw him only occasionally, made no inquiry into the real relation of Eager to the company, what interest he had in it, or how he obtained money to carry on the work.

In substance, the master reported that the intervening petitioners believed that they were dealing with Eager as principal contractor. The proof fully sustains this conclusion. All the estimates introduced in evidence upon which payments were made bear the name of Eager as principal contractor, and every circumstance in the case rebuts the idea that the intervening petitioners either believed or had reason to believe that they were doing their work for, or furnishing their material to, the company instead of to Eager. The most conclusive evidence on this point is that nearly every one of the intervening petitioners subsequently brought suit and recovered judgment on his claim in the State court, against Eager as principal contractor and against the company as garnishee. It is said that this does not estop the lienholders from showing that Eager was actually the agent of the company, because Eager and the company had fraudulently misled them into thinking that there was no such relation of agency between him and the company. Conceding that no estoppel arises from the judgments, they have great probative force in establishing that neither Eager nor the company did anything or said anything from which the petitioners could infer the existence of the agency. Indeed, the very argument upon which the effect of the judgments as an estoppel against the present contention of the petitioners that Eager was the agent of the company is sought to be explained away, has for its premise that the petitioners had no reason to suppose that Eager was anything but the principal contractor, and were led to believe, both by him and the company, that no such agency existed.

It follows necessarily that Eager was not the agent of the company in contracting with the petitioners for the construction of the road, unless the company had in fact conferred authority upon him to act as its agent in the matter. An agency

is created—authority is actually conferred—very much as a contract is made, *i. e.*, by an agreement between the principal and agent that such a relation shall exist. The minds of the parties must meet in establishing the agency. The principal must intend that the agent shall act for him, and the agent must intend to accept the authority and act on it, and the intention of the parties must find expression either in words or conduct between them.

Now, did the relation in fact exist? There certainly was a contract between Eager as an individual and the Knoxville Southern Railroad Company as a corporation, entered into before May, 1890, and probably much earlier—certainly before any of the construction, lien claims for which are here involved, was contracted for—in which Eager agreed to construct the road at a price of $20,000 in bonds and $20,000 in stock per mile, and other considerations. It is said that this contract was a sham and a fraud, dated back nearly three years to save the bondholders of the Marietta and North Georgia Railway Company, and to cheat the petitioners out of their claims. The fact that the contract was signed by Arthur as vice-president shows that it must have been executed some months after its date, because the date is August 20, 1887, and Arthur was not elected vice-president until 1888. Moreover, it was during 1888 that the president reported to the stockholders that the work was progressing under the North Georgia Construction Company as contractor, instead of Eager. But the contract was spread on the minutes of the company in May, 1890, so that it must have been executed before that time. The evidence of one or two witnesses points to its existence before March or April of that year. All of the work and labor sued for below was contracted for by Eager after March and substantially after May, 1890. Even if the reduction of the contract to writing was delayed until 1890, this by no means shows that there had not been before that time a verbal contract, the terms of which had been fully understood between the parties. All the circumstances point to the existence of such a contract. Eager was principal stockholder and president of the North Georgia Construction Company, which was referred to on the company's minutes as contractor in 1888, and Eager says that this company transferred its contract liabilities and rights to him. This is entirely consistent with the probabilities, and there is nothing in conflict with it. Now, whether the contract of the company was originally made with the North Georgia Construction Company or with Eager is immaterial in this discussion, if neither was the agent of the company but was an independent con-

tractor. The delay in the execution of the formal contract with Eager was doubtless due to the fact that, in the minds of the individuals whose duty it was to attend to it, the Marietta and North Georgia Railway Company and the Knoxville Southern Railroad Company were the same enterprise, and Eager's contract with the former was supposed to cover his work on the latter road, just as the bonds and mortgage of the former were evidently supposed to be in effect the bonds and mortgage of the latter. There is not, however, anywhere in the proof a single circumstance or statement that either the company or its directors intended, or that Eager intended, his relation to the company in constructing the road to be anything other than what he always said it was, and what the petitioners understood it to be—that of principal contractor.

The proof is undisputed that Eager received the bonds at the rate of $20,000 per mile of completed road from the trust company, as contractor, and that he sold them as contractor, and this during the years from 1887 to 1890. He never accounted to either railroad company for the proceeds of the bonds. Neither company ever demanded such an account from him. He took them as his property—as his compensation under a contract for work done. Such conduct is not to be reconciled with his being an agent either in the work or in the negotiation of bonds.

We are clearly of the opinion, therefore, that the contract of August, 1887, whenever executed, correctly represents Eager's actual relation to the company in constructing its road. The contract was one out of which Eager hoped to make profit for himself. . . .

The reasoning by which the master, and presumably the court below, reached the conclusion that Eager was the agent of the company, may be seen from the following passage in his report:

> "Above it was said that the Knoxville Southern Railroad Company had only a formal existence, because of Eager's ownership and control and direction of all its affairs and its officers and agents. This is true; but still in trying to discover and enforce the rights of the parties who may have dealt with said company and with Eager, it is impossible to ignore the legal existence of said company. Eager's omnipotence was exercised through formal legal methods, and his power was derived from and based upon the large stock he held in the company, which he received as part pay for the building of the road. But this interest of Eager in the road, and his control of the

company and all its officers and agents, made him its general agent—its plenipotentiary; and whatsoever he did in the building of the road, whatever contracts he made, or were made by agents of his, for material or work, for and upon said road, must be regarded as acts and contracts of the company itself, and binding upon it. He could not, by hiding his true relation to the company, shield the company from liability to those he dealt with; as soon as the facts were known that liability might be asserted."

We are wholly unable to concur with the foregoing. Whether Eager hid has true relation to the company depends on whether he was its contractor or its agent. He said he was its contractor, and nothing stated by the master shows otherwise. The corporation was a legal entity different from Eager, having its existence under the statutes of Tennessee, and governed by its directors in accordance with the law of its creation. Its directors made a contract with Eager. They intended that to be a binding contract on the company. Eager intended it to be. The company through its legal and authorized governors and agents, therefore, made a contract with Eager.

There is no law which makes it impossible for a majority stockholder to enter into a contract with his company. *Wright v. Kentucky & Great Eastern Railway Company,* 117 U. S. 72, 95.

As already explained, the company may appeal to a court of equity to set such contract aside, if it is unfair or unconscionable, for fraud or undue influence, but until this is done the contract expresses the true relation between the parties. The fact that a man has controlling influence with another does not make him that other's agent, unless the other intends such relation to exist, or so acts as to lead third persons to believe that it exists. What is true between individuals is true between an individual and a corporation. In the case at bar, the master fully admits that there was no holding out of agency in Eager by the company. His finding that an agency in fact existed rests simply on the influence which Eager had over the company, and not in any intention of either that Eager should act as its agent in the construction of the road, and his conclusion is reached in the face of the fact, which he fully admits, that they both intended Eager to be an independent contractor. The master's conclusion cannot be supported. . . .

(The court then decides that on the second question, whether anything was owing Eager from the company, the case must go back for a rehearing.)

Decree reversed.

§343. *The Legal Theory of Organization.*—In this case Judge Taft gives a formal exposition of the law's attitude respecting several phases of business organization. In it there is a recognition of the separate corporate entity which must not be confused with the individuals interested in it, regardless of any question of control.[1] Again, on the question whether agency in fact existed, there is an insistent emphasis of the idea that no agency can exist without a more or less formal appointment or a definite, legally recognized substitute therefor; the fact of substantial control of the corporation by one man did not constitute him an agent. Finally, there is a hard and fast distinction between the independent contractor who stands outside of a particular business organization, although he works for it and the agent, or servant who stands within the organization. While all of these propositions, as abstract legal propositions, are irrefutable, it is not always easy to draw clear lines around the various types of relationships in actual business. For example, it is sometimes extremely difficult to determine whether a man working on your premises is an independent contractor or temporarily a part of your organization, yet questions of liability may turn entirely on the answer to this question.

Thus, if a workman is employed to repair the motor trucks used in A's business and in the course of his work injures another, A may or may not be liable for injuries caused by the negligence of the workman. It is quite conceivable that the workman was an independent contractor, although all or most of his time was actually spent in doing work for A. The manner in which he is paid—whether by the week or by the job—is evidence, but hardly conclusive evidence. It is commonly said that the true test is the question of the degree of control exerted

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[1]See also *Donnell v. Herring-Hall-Marvin Safe Co.* (1907), 208 U. S. 267, in which Mr. Justice Holmes uses the following language at page 273: "Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships, and the other groups into a single conception. But to generalize is to omit and in this instance to omit one characteristic of the complete corporation as called into being under modern statutes, that is most important in business and in law. A leading purpose of such statutes and of those which act under them is to interpose a nonconductor through which in matters of contract it is impossible to see the man behind."

over the workman while he is being employed, but this test, growing out of conditions of domestic organization, is becoming less and less significant under the actual facts of business as they are today.

Again, as corporations are actually conducted today, it is not always easy to find the specific moment at which a man who practically controls the corporation may have been constituted its agent for particular purposes. The fine, logical theory of a separate, corporate entity is not always respected, and there are times when even courts are forced to disregard it.[2]

With the propositions laid down in the above case, contrast the rules applicable in a partnership. There, because of the lack of an entity theory, it is clear that a partner cannot become an independent contractor.[3]

PRACTICE PROBLEM

(a) X and Y each own one-half of the stock of a certain corporation. The plaintiff, as assignee of A under a general assignment for the benefit of creditors, is suing the corporation for goods sold and delivered by A. Both X and Y have unsatisfied judgments against A upon causes of action which accrued before A's assignment to the plaintiff, and the estate of which the plaintiff is the assignee is hopelessly insolvent. Are X and Y entitled to intervene and interpose their claims against A as setoffs to the claim of the plaintiff against the corporation. See *Gallagher v. Germania Brewing Co.* (1893), 53 Minn. 214.

§344. *From James E. Hogg, Legal Conceptions from a Practical Point of View*, 22 Law Q. Rev. 174.

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[2]Two exceptions to the general rule of separate corporate existence and liability have received judicial recognition: "(1) The legal fiction of distinct corporate existence will be disregarded when necessary to circumvent fraud; (2) it may also be disregarded in a case where a corporation is so organized and controlled and its affairs are so conducted as to make it merely an instrumentality or adjunct of another corporation." Noyes, J: *In re Watertown Paper Co.* (1909), 169 Fed. 252, 256. For able discussions of this topic see Professor I. M. Wormser's article, *Piercing the Veil of Corporate Entity*, in 12 Col. L. Rev., 496; and the article by Professor George F. Canfield on the *Scope and Limits of the Corporate Entity Theory* in 17 Col. L. Rev. 128.

[3]On the entity theory as applied to partnership see the discussion between Professor Judson A. Crane and Dean William Draper Lewis in 28 Harv. L. Rev. 762, 29 *ibid.* 158, 291, 838.

[What is the bearing of the "entity theory" as a business fact? The popular view is well contrasted with the traditional view of lawyers in the following paragraphs]:

"Questions relating to the rights and methods of enforcing the rights, of natural persons who constitute a firm or other body of persons more or less organized, of the artificial or group persons known as corporations aggregate, and of the natural persons who are members of a corporation aggregate—questions of this kind afford striking illustrations, and perhaps the most interesting illustrations in the eyes of a jurist at the present day, of the divergence between the technical and the popular view. On the one hand, the popular view of a firm or a trade union is that they are legal entities hardly distinguishable from the lawyer's corporation aggregate, and are really conceived of as having a personality and legal rights and liabilities distinct from the personalities, rights, and liabilities of the persons constituting them. On the other hand, the essential feature of a corporation, and its recognition in law as an entity or personality distinct from the whole sum of the natural persons who are its members, are frequently overlooked by business men, especially as regards corporations constituted by registration under the Companies Acts. A business man who is a member of a firm nearly always thinks of his firm or 'house' as a separate entity. But if he and his partners take advantage of the Companies Acts in order to secure limited liability, they and the general public will seldom appreciate the fact that, as the law now stands, registration under the Acts has brought a new corporation into existence. Hence the very prevalent custom of addressing limited companies as *Messrs.* Brown, Jones and Robinson, *Limited;* this technically incorrect usage is even adopted by lawyers, as may be seen by a letter from the author to the publishers prefixed to the second (temporary) volume of Williams' *Vendor and Purchaser.*

In this branch of law it seems possible that the efforts of jurists to bring about some sort of reconciliation between technical and popular views may at no distant date prove successful, and that the legal conception of a 'person' may be so far widened as to find room for group or collective persons other

than what are now known as corporations. The subject of the true nature of the corporation has been much discussed in recent years, and the liking of English lawyers for the 'fiction' theory appears now to be on the wane.[1] If the theory of the corporation being a real group or collective persons, above and distinguished from the natural persons who are its members, comes to be recognized as the true theory of the English law of corporations, the recognition of organized bodies of men, which are not technically corporations, as legal entities would seem to be somewhat nearer. The language of the Courts and the Legislature appears to be growing bolder, both in recognizing the reality of a corporation's personality, and in recognizing the eventual possibility of non-corporate bodies of men becoming real legal entities.''

§345 *LAFLIN & RAND CO. v. STEYTLER.*

Supreme Court of Pennsylvania, 1892. [146 *Pa. St.* 434.]

MR. JUSTICE MITCHELL.: The limited association act of June 2, 1874, P. L. 271, was a wide departure from the principles of the common law governing partnerships and the liability of the individual partners to the firm creditors. It was not the first, nor has it been the last of such changes. On the contrary, it is but one step in a line of concessions to the business views and habits of a commercial age and community, and it should be construed in the spirit of its enactment. A review of the course of legislation may help us towards the true intent of the statute.

The act of March 21, 1836, P. L. 143, was an elaborate scheme for the introduction of a new kind of partnership, not previously known to the law. One or more general partners were required, and they alone were authorized to transact the business or sign the firm name, and their names alone, without the word company or other general term, could appear in the

[1]See an article in the L. Q. R., vol. xxi, p. 365 (Oct. 1905) by Professor Jethro Brown, and references there to the writings of Professor Maitland and Mr. Dicey; Pollock and Maitland, *History of English Law* (2nd ed.), vol. i, p. 486, note; Pollock on *Contracts* (7th ed.), 113-116; Pollock *First Book of Jurisprudence* (2nd ed.), 112. [On the whole subject see George Wharton Pepper, *Irregular Associations,* 43 Am. Law Reg. at 415, and the same author's *Brief Introduction to the Study of the Law of Association,* 49 *ibid* 255; Maitland's edition of Gierke's *Political Theories of the Middle Ages.*]

firm title. The special partners must contribute actual cash as part of the capital, could not withdraw any part of it during the term, nor receive profits or even interest which lessened its amount; and any violation of these provisions, or any participation in the transaction of the business with the public, or the appearance of their names in the firm title, subjected them to be treated as general partners. A certificate of the facts had to be sworn to, acknowledged in the manner of acknowledgment of deeds, and recorded, before the partnership was legally constituted; and any change as to any fact set forth in the certificate must be again certified in like manner, on penalty of liability of all parties as general partners. The influence of common-law ideas of partnership is apparent throughout the act. It was manifestly regarded as an experiment, to be entered upon cautiously and hedged about with restrictions. But the act met the needs of the community, and in the language of the present hour, it had come to stay. After more than half a century it is still on our statute books as the basis of the system, and every change since has been a step forward in the same direction, and not backward. By joint resolution of April 16, 1838, P. L. 691, a partner, general or special, or his executor in case of his death, could, with the assent in writing of the others, sell and assign his interest without causing dissolution, such alterations being certified, etc., as before. By the act of April 21, 1858, P. L. 383, the sale of a partner's interest, or an increase of the capital, either by increased contributions from the original partners or by taking in new special partners, could be provided for in advance in the articles of partnership or in a separate instrument, such changes being required to be certified and recorded as before; but, most notable of all, the omission to record was not to work a dissolution as before, or subject the special partners to general liability. The spirit of progressive legislation had discovered that changes which left the business intact, or even increased in capital, did not demand the punishment of special partners by imposing general liability for neglect of mere formalities. The act of March 30, 1865, P. L. 46, made two important further changes: The firm title, where there were more than two general partners, may contain the words "and company" (previously forbidden), the names in full of all the partners special as well as general being put upon a sign; and the special partners were allowed to contribute their share of the capital in goods, the value, however, being first appraised under oath by an appraiser appointed by the Court of Common Pleas. By the act of February 21, 1868, P. L. 42, the firm name may consist of the name of any one

general partner, with the addition "and company," notwithstanding the name may be common to such general partner and any special partner, but the sign must be put up as required by the act of 1865.

This was the state of the law when the Legislature passed the Act of June 2, 1874, P. L. 271, for the formation of partnership associations with limited liabilities, under which the present defendants were organized. By this act, no general partners are required, nor is any restriction put upon the firm name or title, except that the word "limited" must be the concluding word. The persons desiring to form the association must sign and acknowledge a statement, setting forth *inter alia* "the full names of such persons." The act speaks only of "subscribing and contributing capital," total amount, "and when and how to be paid," etc. But, this being held to mean money capital only, a supplement was passed May 1, 1876, P. L. 89, authorizing contribution "in real or personal estate, mines, or other property, at a valuation to be approved by all the members." The Act of 1874, it will be seen, was not a mere amendment or supplement to anything that went before, but, like the Act of 1836, a new scheme, carefully and elaborately drawn, creating a new kind of artificial person, standing between a limited partnership as previously known and a corporation, and partaking of the attributes of each. It was, however, a step forward in the same line of legislative recognition of business demands uniformly pursued since the start, in 1836.

With this review, we may now turn to the two points specially involved in the present case. And first, we are to inquire what is meant by the full names of the members. This phrase first made its appearance in the Act of 1865, in connection with the requirement that there should be "put up in some conspicuous place on the outside and in front of the building," a sign on which should be painted in legible English characters, "all the names in full of all the members of said partnership, stating who are general and who are special partners." Previously to this act, only the names of the general partners could appear in the firm title, and "without the addition of the word company or any other general word." This act required the use of the names of all the general partners except where there might be more than two, in which case the names of any two could be used with the addition of the words "and company," and the sign, as already noted, "stating who are general and who are special partners." This last requirement is the keynote of the intent; it was to give information to the public as to the persons who composed the firm, and the capacity in

which they stood connected with it, as generally or only specially responsible. The object aimed at was the identification of the person, and the requirement of his full name had nothing further in view. A man's name is the designation by which he is distinctively known in the community. Custom gives him the family name of his father, and such praenomina as his parents choose to put before it, and appropriate circumstances may require Sr. or Jr. as a further constituent part. But all this is only a general rule from which the individual may depart if he chooses. The Legislature in 1852[1] provided a mode of changing the name, but that act was in affirmance and aid of the common law, to make a definite point of time at which a change shall take effect. But without the aid of that act a man may change his name or names, first or last, and when his neighbors and the community have acquiesced and recognized him by his new designation, that becomes his name. Two noted examples are at hand for illustration. The blunder of the friendly Congressman who nominated him to West Point transposed and altered the names by which General Grant has gone into history, and considerations of convenience or taste have induced President Cleveland to omit one of the names his parents bestowed upon him. A name, therefore, is the title used for the identification of an individual, and the intent of its requirement in full is certainty of such identification. The full name, therefore, is no more than the whole of such title, as it is used by himself and his neighbors for such purpose. To construe the statute to require the literal and absolute following of the entire list of names which the person may have had bestowed upon him, would be giving it not only a very narrow and technical construction, which serves no purpose of the act, but even one which might tend to defeat its real intent. A statement signed "Stephen Grover Cleveland" would not create certainty, but doubt, as to its author.

The Act of 1874, as already said, made no restrictions upon the firm title, except the compulsory termination "limited," and omitted the requirement of the sign, but in lieu thereof substituted the statement containing the "full names" of the persons composing the association. This phrase was borrowed from the Act of 1865, and its intent was the same in both, to secure the identification of the individual by having his name plainly set forth, in the full form by which the community would recognize him. The appellants gave evidence that the names as signed to the statement were in the form habitually

[1]Act of April 9, 1852, P. L. 301.

used by them in business and by which they were generally known in the community. This, if proved, was a sufficient compliance with the statute.

The Act of 1836 required the special partners to contribute actual cash, and for nearly thirty years this requirement was absolute and unyielding. The Act of 1865 for the first time permitted goods to be put in as capital, but required their value to be fixed by a sworn appraiser appointed by the court. The Act of 1874, as amended in 1876, did away with all these restrictions, and allowed the capital to be contributed in "real or personal estate, mines, or other property," without any other check as to the valuation than the agreement of all the subscribers. The statement is to certify the kind of capital contributed, whether money or property, and in the latter case, a schedule with a description and valuation. By the plain terms of the act the violation is in the discretion of the parties, and (assuming, of course, good faith) may be sanguine or cautious: *Rehfuss v. Moore,* 134 Pa. 462. The description, therefore, is plainly for the information of parties interested, so that they may, if they desire, have the data for their own judgment of value. Accordingly it has been uniformly held by this court that a vague, or general, or lumping description is not sufficient: *Maloney v. Bruce,* 94 Pa. 249; *Vanhorn v. Corcoran,* 127 Pa. 255. It is not intended, however, nor would it be practicable, in many cases where an existing business is the basis of the new firm, to require minute specification of details that may change from day to day. Certainty to a fair business intent is the safe, practical criterion, as was indicated in *Rehfuss v. Moore,* 134 Pa. 462, where a lumping valuation of six distinct patent rights, at a very high figure, was sustained on the ground that they were all expected to be used in the operation of a single device embodying the principle of all, and were considered valuable only in combination. The schedule in the present case described several tracts of land which it appears were acquired by different titles, but which had been merged together and formed into a coal-works called the Buffalo Mines. The schedule valued them as one tract. It also set out certain buildings, tenement houses, engines, etc., in considerable but not minute detail, valuing each item separately, but as a part of one entire plant for the operation of coal mining. It is claimed that the various items of property are sufficiently specified and described for a creditor or the sheriff to go upon the land and identify or levy upon them. This was sufficient. The act expressly mentions "mines" as the subject of contribution as

capital, and it cannot be intended that every pick and shovel, or mule and harness, should be specified and valued separately. A fair business description of the mine and its equipment is all that the statute requires.

Judgment reversed, and venire de novo awarded.

§346. *Statutory Partnerships.*—The foregoing case describes two special forms of association which came into existence in Pennsylvania by virtue of legislation, namely: (1), limited partnership, and (2) limited partnership association.

Limited partnerships, called special partnerships in some states, exist by virtue of legislative authority in most of our states. In 1916 the Conference of Commissioners on Uniform State Laws approved a Uniform Limited Partnership Act which has already been adopted by Alaska, Illinois, Maryland, Pennsylvania, Tennessee, and Virginia. The object of limited partnership legislation was succinctly stated by the draftsman of the Uniform Act: "The draft proceeds on the assumption, that persons in business should be able, while remaining themselves liable without limit for the obligations contracted in its conduct, to associate with themselves others who contribute to the capital and acquire rights of ownership, provided that such contributors do not compete with creditors for the assets of the partnership." It is of the utmost importance to comply with all statutory requirements for the formation of this type of association and, furthermore, every limited partner should never forget that if, in addition to the exercise of his rights as a limited partner, he participates in the control of the business, he will be held liable as a general partner.

The second type of statutory partnership described in the Laflin case—the "limited partnership association"—does not differ in any essential respect from "joint stock associations" (of which the American Express Company is an example) authorized by statute in New York. If the statutory provisions are adhered to, the capital alone is liable for the debts and none of the partners in these associations is subject to individual liability. Such associations exist in Michigan, New Jersey, New York, Ohio, Pensylvania, and Virginia.

B. In Agency.

§347 *LYON & CO. v. KENT, PAYNE & CO.*

Supreme Court of Alabama, 1871. [45 *Ala.* 656.]

[Action of detinue for the recovery of a quantity of cotton. Judgment for plaintiffs. Defendants appeal.

Kent, Payne & Co., citizens of Virginia, had, during the Civil War, a quantity of cotton in Alabama, in the custody of their agent, Browder. They gave to Singleton, a citizen of Illinois, an order upon Browder for the cotton. Singleton took possession of it, and subsequently sold it to Guy. Guy deposited it for storage in the warehouse of Lyon & Co. There was a conflict of evidence as to whether Singleton was given authority to sell the cotton, or any title passed to him.]

PETERS, J.: (after deciding that a sale to Singleton would have been void as a commercial transaction between citizens of hostile portions of the country.) Yet, though the order of itself was not evidence of a sale to Singleton, or a power to sell, it shows that the owners of the cotton had authorized him to *take possession* of it. This he could do as the agent of the owners. This was not forbidden to him or to them by law, or the policy of the government. They could change the agency of the custody of their cotton from one person to another; and they could make any person, capable of acting as an agent, such agent to take possession of their property for them, and keep it for them. They could transfer its custody from Browder to Singleton without a violation of law. The objection which might be supposed to exist to such an agency during the war ceased as soon as the war was ended; and its purpose being then legal, it might be legally consummated. Any one, except a lunatic, imbecile, or child of tender years, may be an agent for another. It is said by an eminent author and jurist, that "it is by no means necessary for a person to be *sui juris,* or capable of acting in his or her own right, in order to qualify himself or herself to act for others. Thus, for example, monks, infants, *femes covert,* persons attainted, outlawed, or excommunicated, villains and aliens, may be agents for others." Story's *Agency,* §§6, 7, 9. So, a slave, who is *homo non civilis,* a person who is but little above a mere brute in legal rights, may act as the agent of his owner or his hirer. *Powell v. The State,* 27 Ala. 51; *Stanley v. Nelson,* 28 Ala. 514. It was, then, certainly not unlawful, or against the public policy of the nation, for Kent, Payne & Co. to keep their cotton, and keep it safely, during the late rebellion. It is the undoubted law of agency, that a person

may do through another what he could do himself in reference to his own business and his own property; because the agent is but the principal acting in another name. The thing done by the agent is, in law, done by the principal. This is axiomatic and fundamental. It needs no authorities to support it. *Qui facit per alium, facit per se.* Broom's *Max.*, margin; 1 Parsons on *Cont.* 5th ed. p. 39 *et seq;* Story's *Agency,* §440. And to this it may be added that an agent, in dealing with the property of his principal, must confine his acts to the limit of his powers; otherwise the principal will not be bound. 1 Parsons on *Cont.* 41, 42, 5th ed.; *Powell v. Henry,* 27 Ala. 612; *Botts v. McCoy et al.,* 20 Ala. 578; *Allen v. Ogden,* 1 W. C. C. 174. And it is also the duty of one dealing with an agent to know what his powers are, and the extent of his authority. *Van Eppes v. Smith,* 21 Ala. 317; *Owings v. Hull,* 9 Pet. 608. Then, the agency to receive the delivery of cotton from Browder, in compliance with the order, was not illegal. If it went beyond that it was void. And those who dealt with Singleton were bound to know this, as they were bound to know the law. 9 Peters, 608, *supra.*

There was conflict in the testimony before the jury as to the extent and character of the agency of Singleton. There was a wide difference between his statement and that of Kent, with whom he transacted the business about the cotton, as to the purpose and scope of the agency intended to be established. It is not to be presumed that the parties intended to violate the law. But whether they did or not, and what were the powers intended to be conferred upon the agent, are questions for the jury. This is the effect of the charge. It was pertinent to the testimony, and does not misstate the law. Such a charge is not error.

(The court then decides that there was no error in refusing certain charges asked for by the defendants.)

Judgment affirmed.

§348. *"Qui Facit Per Alium Facit Per Se."*—Is the doctrine, *qui facit per alium facit per se,* so axiomatic as the court would have us believe? As a matter of history, the doctrine was unknown in Roman law and comes into modern law through the canon law of the mediæval church (*Liber sextus decretalium,* V. 12, 72). Where the canon law got it is not so clear, but it is not inconceivable that the source of its legal ideas on vicarious action should be the same as the source of its theological notions of vicarious sin and atonement. The doctrine of

representation is well established in the law of the Orient and particularly in the Talmud. Wenger has recently shown that in this business theory as in so many others, Greek law was similar to that of the Orient, and that it maintained its peculiarities until late in the Christian era. It is, therefore, conceivable that the idea came into Europe through Greece.[1] At any rate the doctrine of identity of principal and agent seems axiomatic only after we have heard it repeated often enough to lose all sense of its meaning. For various views on the history of the doctrine of Representation, compare Fraenkel, *Grundsätze der Stellvertretung bie den Scholastikern,* 27 *Z für Vergl. Rw.* 289; *Kohler, Zur Entwicklung der Stellvertretungslehre, ibid.* 440; Holmes, *History of Agency,* 4 Harv. L. Rev. 345, 5 *ib.;* reprinted in *Select Essays in Anglo-American Legal History,* vol. III, 368.

§349. *Agency and Contract.*—Agency is often loosely regarded as merely a specialized contract. What is there in the court's discussion in *Lyon & Co. v. Kent, Payne & Co.* to indicate the fallacy of this common notion?

Agency, like marriage, is a relation which, although based on consent of the parties, has certain incidents firmly annexed by force of law. The relationship itself, although consensual, is not a contract. But the relationship is in business, preceded by a contract directed to the future formation of the relationship. And law writers are constantly stressing the contractual analogies and overlooking the domestic relation analogy and other analogies in which the contractual phase was weak or absent.

The notion that the relation between employer and employee was purely a contractual one led, under the conception of constitutional freedom of contract, for some time, to non-interference by the legislature in the terms of employment. Towards the close of the last century, there was a decided swing in the opposite direction.[1] Nevertheless, from 1890 to 1910, courts

[1]Wenger, *Die Stellvertretung im Rechte der Papyri,* 1906, pp. 172, 207f., 218f., cited in Fraenkel, *infra.*

[1]For a discussion of this social legislation see §8, *supra.*

resisted as unconstitutional most of the attempts of the legislatures to dictate the terms of the agreement between employers and employees. For example, legislation against company stores and payment in company "scrip" was at first declared unconstitutional. Hours of labor was another subject that legislatures attempted to control, at first without success, but finally, it seems, with little or no opposition. The first inroads into the older doctrine of the courts was in connection with dangerous occupations.

§350. *From Felix Frankfurter, Hours of Labor and Realism in Constitutional Law,* 29 *Harv. L. Rev.* 353—"1898 *Holden v. Hardy,* 169 U. S. 366, sustained a Utah statute limiting to eight the hours of labor in underground mines. Familiar as this case is, a few sentences from the powerful opinion of Justice Brown will bear re-quoting:

> 'The enactment does not profess to limit the hours of all workmen, but merely those who are employed in underground mines, or in the smelting, reduction or refining of ores or metals. These employments, when too long pursued, the legislature has judged to be detrimental to the health of the employees, and, so long as there are reasonable grounds for believing that this is so, its decision upon this subject cannot be reviewed by the Federal courts' (p. 395).
>
> 'The legislature has also recognized the fact, which the experience of legislators in many states has corroborated, that the proprietors of these establishments and their operatives do not stand upon an equality, and that their interests are, to a certain extent, conflicting. The former naturally desire to obtain as much labor as possible from their employees, while the latter are often induced by the fear of discharge to conform to regulations which their judgment, fairly exercised, would pronounce to be detrimental to their health or strength. In other words, the proprietors lay down the rules and the laborers are practically contrained to obey them. In such cases self-interest is often an unsafe guide, and the legislature may properly interpose its authority' (p. 397).
>
> 'The question in each case is whether the legislature has adopted the statute in exercise of a reasonable discretion, or whether its action be a mere excuse for an un-

just discrimination, or the oppression, or spoliation of a particular class' (p. 398).

1899 *Re Morgan,* 26 Colo. 415. The opinion of the United States Supreme Court in *Holden v. Hardy, supra,* was not convincing to the Supreme Court of Colorado, and with sturdy independence that court nullified a similar eight-hour law as to underground mines.

> 'The result of our deliberation, therefore, is that this act is an unwarrantable interference with, and infringes the right of both the employer and employee in making contracts relating to a purely private business, in which no possible injury to the public can result' (p. 450).

1902 *Re Ten-Hour Law for Street Railway Corporations,* 24 R. I. 603, in an advisory opinion declared constitutional a ten-hour statute for employees operating street railways.

1904 *Ex parte Boyce,* 27 Nev. 299; followed in *Ex parte Kair,* 28 Nev. 127; *ibid.,* 425 (1905); and

1904 *State v. Cantwell,* 179 Mo. 245, sustained an eight-hour law for underground mining work.

1911 *Baltimore & Ohio R. R. v. Interstate Commerce Commission,* 221 U. S. 612, sustained the constitutionality of the Hours of Service Act of March 4, 1907.

> 'The fundamental question here is whether a restriction upon the hours of labor of employees who are connected with the movement of trains in interstate transportation is comprehended within this sphere of authorized legislation. This question admits of but one answer, the length of hours of service has direct relation to the efficiency of the human agencies upon which protection to life and property necessarily depends. This has been repeatedly emphasized in official reports of the Interstate Commerce Commission, and is a matter so plain as to require no elaboration. In its power suitably to provide for the safety of employees and travelers, Congress was not limited to the enactments of laws relating to mechanical appliances, but it was also competent to consider, and to endeavor to reduce, the dangers incident to the strain of excessive hours of duty on the part of engineers, conductors, train dispatchers, telegraphers, and other per-

sons embraced within the class defined by the act. And in imposing restrictions having reasonable relation to this end there is no interference with liberty of contract as guaranteed by the Constitution' (pp. 618-619)."

§351. *Limitations on Labor Agreements of Persons Sui Juris.* —The doctrine was later extended to the employment of women in all kinds of occupation, and finally, to regulation of the hours of labor for men. See Pound, *Liberty of Contract,* 18 Yale L. J. 454, and the later cases cited in §10, *supra;* especially *Bunting v. Oregon,* (1916) 243 U. S. 426. The brief of Professor Frankfurter and Miss Josephine Goldmark in the latter case has been reprinted by the National Consumer's League. It contains information about legislation on these subjects throughout the world and much valuable sociological material.

§352 *JENSEN v. SOUTHERN PACIFIC CO.*

Court of Appeals of New York, 1915. [215 *N. Y.* 514.]

MILLER, J.: The claimant's husband was killed on August 15th, 1914, while employed in unloading the steamship, *El Oriente,* which was berthed alongside a pier in the Hudson River. When the accident occurred he was moving an electric truck upon a gangway connecting the vessel with the pier. The appellant, a corporation of the state of Kentucky, is a common carrier by railroad. It also owned and operated said steamship, which plied between New York and Galveston, Texas. It does not appear that the steamship was in any way operated in connection with a line of railroad, and in its report of the accident the appellant stated its business to be "transportation by steamships engaged solely in interstate commerce." We are required on this appeal, first, to construe the Workmen's Compensation Law (Chap. 67 of the Consolidated Laws; L. 1914, ch. 41) in so far as it relates to this case, and, second, to determine its constitutional validity. The scheme of the statute is essentially and fundamentally one by the creation of a state fund to insure the payment of a prescribed compensation based on earnings for disability or death from accidental injuries, sustained by employees engaged in certain enumerated hazardous employments. The state fund is created from premiums paid by employers based on the payroll, the number of employees and the hazards of the employment. The employer has the option of insuring

with any stock corporation or mutual association authorized to transact such business, or of furnishing satisfactory proof to the commission of his own financial ability to pay. If he does neither he is liable to a penalty equal to the *pro rata* premium payable to the state fund during the period of his non-compliance and is subject to a suit for damages by the injured employee, or his legal representative in case of death, in which he is deprived of the defenses of contributory negligence, assumed risk and negligence of a fellow-servant. By insuring in the state fund, or by himself or his insurance carrier paying the prescribed compensation, the employer is relieved from further liability for personal injuries or death sustained by employees. Compensation is to be made without regard to fault as a cause of the injury, except where it is occasioned by the willful intention of the injured employee to bring about the injury or death of himself or another or results solely from his intoxication while on duty. Compensation is not based on the rule of damages applied in negligence suits, but in addition to providing for medical, surgical or other attendance or treatment and funeral expenses it is based solely on loss of earning power. Thus the risk of accidental injuries occurring with or without fault on the part either of employee or employer is shared by both and the burden of making compensation is distributed over all the enumerated hazardous employments in proportion to the risks involved. So much for the general outline of the scheme against whose justice or economic soundness nothing, that occurs to me, can be said.

The particular provisions requiring construction are the following:

"Section 2. *Application.* Compensation provided for in this chapter shall be payable for injuries sustained or death incurred by employees engaged in the following hazardous employments: . . .

"Group 8. The operation, within or without the state, including repair, of vessels other than vessels of other states or countries used in interstate or foreign commerce, when operated or repaired by the company. . . .

"Group 10. Longshore work, including the loading or unloading of cargoes or parts of cargoes of grain, coal, ore, freight, general merchandise, lumber or other products or materials, or moving or handling the same on any dock, platform or place, or in any warehouse or other place of storage." . . .

. . . We now come to perhaps the most important question in the case: Does the act violate the Fourteenth Amend-

ment to the Constitution of the United States for taking property without due process of law?

Much reliance is placed on the decision of this court in *Ives v. South Buffalo Ry. Co.* (201 N. Y. 271, 294). In that case Judge WERNER, referring to the appeal on economic and sociologic grounds and speaking for the court, said: "We have already admitted the strength of this appeal to a recognized and widely prevalent sentiment, but we think it is an appeal which must be made to the people and not to the courts." That decision was made in March, 1911. Following that suggestion, the legislature provided in the orderly way prescribed by the Constitution for the submission to the people of a proposed constitutional amendment and in due time that amendment was adopted on November 4th, 1913, and became section 19 of article 1 of our State Constitution. It is unnecessary to set that amendment forth *in extenso,* but it suffices to say that so far as the due process clause or any other provision of our State Constitution is concerned the amendment amply sustains the act. However, it is urged that the reasons which constrained the court to declare the act involved in the *Ives* case unconstitutional are equally cogent when applied to the Fourteenth Amendment. In the first place it is to be observed that the two acts are essentially and fundamentally different. That involved in the *Ives* case made the employer liable in a suit for damages though without even imputable fault and regardless of the fault of the injured employee short of serious and willful misconduct. This act protects both employer and employee, the former from wasteful suits and extravagant verdicts, the latter from the expense, uncertainties and delays of litigation in all cases and from the certainty of defeat if unable to establish a case of actionable negligence. Both acts are said to have been based on the proposition that the risk of accidental injuries in a hazardous employment should be borne by the business and that loss should not fall on the injured employee and his dependents, who are unable to bear it or to protect themselves against it. That act made no attempt to distribute the burden, but subjected the employer to a suit for damages. This act does in fact as well as in theory distribute the burden equitably over the industries affected. It allows compensation only for loss of earning power, but by the creation of a state insurance fund, or by the substitute methods provided, it insures the prompt receipt by the injured employee or his dependents of a certain sum undiminished by the expenses of litigation. The two acts are, therefore, so plainly dissimilar that the decision in the *Ives* case is not controlling in this.

Moreover, upon the question whether an act offends against the Constitution of the United States the decisions of the United States Supreme Court are controlling. The only one of the numerous Workmen's Compensation Acts which appears to have been directly passed on by the United States Supreme Court is the act of Ohio, which contained an optional clause. (*Jeffrey Mfg. Co. v. Blagg,* 235 U. S. 571.) The single question decided in that case was that limiting the application of the act to shops with five or more employees did not result in arbitrary and unreasonable classification. This act is compulsory. The employer is subjected to a penalty for not adopting one of the three methods of insurance allowed him, and the employee has no choice at all except possibly as to whether he will enter one of the classified employments. However, except for a feature presently to be considered, the decision in *Noble State Bank v. Haskell* (219 U. S. 104) is decisive. Indeed, upon close analysis it will appear that the taking justified in that case as a proper exercise of the police power was no more in the public interest than that involved in this case and that the mutual benefits to the parties immediately concerned were not as direct. In that case an act of the state of Oklahoma requiring every bank existing under the state laws to pay an assessment based on average daily deposits into a guaranty fund to secure the full repayment of deposits in case any such bank became insolvent was sustained not merely under the reserve power of the state to alter or repeal charters but as a proper exercise of the police power. Solvent banks were thus required to pay money into a fund for the direct benefit of others, the banks benefiting only indirectly from the supposed benefit to commerce and the greater stability of banking. In this case the mutual benefits are direct. Granted, that employers are compelled to insure and that there is in that sense a taking. They insure themselves and their employees from loss, not others. The payment of the required premiums exempts them from further liability. The theoretical taking no doubt disappears in practical experience. As a matter of fact, every industrial concern, except the very large ones who insure themselves, have for some time been forced by conditions, not by law, to carry accident indemnity insurance. A relatively small part of the sums thus paid actually reached injured workmen or their dependents. With the economic saving of the present scheme, insurance in the long run should certainly be as cheap as under the old wasteful plan, and the families of all injured workmen, not a part only, will receive some compensation for the loss of earning power of the wage earner. We should consider practical experience as well

as theory in deciding whether a given plan in fact constitutes a taking of property in violation of the Constitution. A compulsory scheme of insurance to secure injured workmen in hazardous employments and their dependents from becoming objects of charity certainly promotes the public welfare as directly as does an insurance of bank depositors from loss.

But for the matter now to be considered we need not look farther for a case controlling upon us and in principle decisive of this. Whilst the *Noble State Bank* case was referred to in the *Ives* case, it was not controlling for the reason that the State Constitution was involved and it was not in point as an authority because of the essential differences in the act then before the court, already pointed out.

A point was made on oral argument that the act was unconstitutional for depriving an employee injured by negligence imputable to the employer of a right of action for the wrong. Of course, the employer cannot be heard to urge the grievance of the employee (*Jeffrey Mfg. Co. v. Blagg, supra*), but exemption from further liability upon paying the required premium into the state fund is an essential element of the scheme, and if the act be unconstitutional as to the employee the employer would be deprived of that exemption and thus would be directly affected by the unconstitutionality of the act in that respect. It is not accurate to say that the employee is deprived of all remedy for a wrongful injury. He is given a remedy. To be sure, the compensation or recovery is limited, and that in a sense may possibly constitute a taking; but if so, it is his contribution to an insurance scheme designed for his benefit, and may be justified on precisely the same grounds as the contribution exacted of the employer has been. When he enters into the contract of employment, he is now assured of a definite compensation for an accidental injury occurring with or without fault imputable to the employer and is afforded a remedy, which is prompt, certain and inexpensive. In return for those benefits he is required to give up the doubtful privilege of having a jury assess his damages, a considerable part of which, if recovered at all after long delay, must go to pay expenses and lawyers' fees.

Moreover, the act does not deal with intentional wrongs but only with accidental injuries, and no account is taken of the presence or absence of negligence attributable to the employer. In the way modern undertakings are conducted it is rarely possible to trace personal fault to the employer, but he has been held liable for wrongs of others under the doctrine of *respondeat superior*. That doctrine has been developed by the courts to make the principal accountable for the conduct of his affairs,

though it must be remembered that it does not rest on the doctrine of agency. No one has a vested right under the Constitution to the maintenance of that common-law doctrine, which undoubtedly may be extended or curtailed by the legislature. No one doubts that the doctrine of assumption of risk and the fellow-servant doctrine, also developed by the courts under different conditions than those now prevailing, may be limited or entirely abrogated by the legislature. Acts having that effect have been sustained by repeated decisions of this court. The power to limit or take away must also involve the power to extend. At the common law the servant was held to assume by implied contract the ordinary risks of the employment, including the risk of a fellow-servant's negligence, and even of negligence imputable to the master if the danger was obvious, or with knowledge of it the servant voluntarily continued in the employment. It would not be a great extension of that doctrine for the legislature to provide that the employee should assume the risk of all accidental injuries, and if that can be done, it is certainly competent for the legislature to provide by the creation of an insurance fund for a limited compensation to the employee for all accidental injuries, regardless of whether there was a cause of action for them at common law.

This subject should be viewed in the light of modern conditions, not those under which the common-law doctrines were developed. With the change in industrial conditions, an opinion has gradually developed, which almost universally favors a more just and economical system of providing compensation for accidental injuries to employees as a substitute for wasteful and protracted damage suits, usually unjust in their results either to the employer or the employee, and sometimes to both. Surely it is competent for the state in the promotion of the general welfare to require both employer and employee to yield something toward the establishment of a principle and plan of compensation for their mutual protection and advantage. Any plan devised by the wit of man may in exceptional cases work unjustly, but the act is to be judged by its general plan and scope and the general good to be promoted by it. Fortunately the courts have not attempted to define the limits of the police power. Its elasticity makes progress possible under a written constitution guaranteeing individual rights. The question is often one of degree. The act now before us seems to be fundamentally fair to both employer and employee. Of course, I do not speak of details, which may or may not be open to criticism, but which, granting the validity of the underlying principle, are plainly within the province of the legislature. It is not open to

the objections found to be fatal to the act considered in the *Ives* case. It is plainly justified by the amendment to our own state Constitution, and the decisions of the United States Supreme Court notably in the *Noble State Bank* case make it reasonably certain that it will be found by that court not to be violative of the Constitution of the United States.

The order of the Appellate Division should be affirmed, with costs.

§352a. *Judicial Notice of Social and Other Historical Facts.* —The court here shows a clear consciousness of the changing conditions in the field of labor and the necessity of the law to develop to meet these changes. Whatever one may think of the advisability of compulsory insurance against industrial accidents as a state venture, it was a fact that such insurance was practically required by business policy long before the state entered the field. Much of the discussion of the merits of workmen's compensation acts, and particularly those involving insurance, seems to overlook this business fact. In reality the transition from the old system to the new was not great; to many business concerns it simply meant payment of a premium to the state instead of to an accident insurance company.

C. In Partnership.

§353 *BEECHER v. BUSH.*

Supreme Court of Michigan, 1881. [45 *Mich.* 188.]

COOLEY, J.: The purpose of the action in the court below was to charge Beecher as partner with Williams for a bill of supplies purchased for the Biddle House in Detroit. The facts are all found by special verdict, and are few and simple. Beecher was owner of the Biddle House, and Williams proposed in writing to "hire the use" of it from day to day, and open and keep it as a hotel. Beecher accepted his proposals and Williams went into the house and began business, and in the course of the business made this purchase. The proposals are set out in full in the special verdict.

The question is whether by accepting the proposals Beecher made himself a partner with Williams in the hotel business; and this is to be determined on the face of the writing itself. It is conceded that Beecher was never held out to the public as a partner, and that the bill of supplies was purchased on the sole

credit of Williams and charged to him on the books of the plaintiffs below. The case, therefore, is in no way embarrassed by any question of estoppel, for Beecher has done nothing and suffered nothing to be done which can preclude him from standing upon his exact legal rights as the contract fixed them.

Nor do we understand it to be claimed that the parties intended to form a partnership in the hotel business, or that they supposed they had done so, or that either has ever claimed as against the other the rights of a partner. It is perfectly clear that many things which are commonly incident to a partnership, these parties meant should be wholly excluded from their arrangement. Some of these were of primary importance. It is plain, for example, that Beecher did not understand that his credit was to be in any way involved in the business, or that he was to have any interest in the supplies that should be bought, or any privilege to decide upon them, or any legal control whatever until proceeds were to be divided, or any liability to losses if losses were suffered. These are among the most common incidents to a partnership; and while some of them, and possibly all of them, may not be necessary incidents, yet the absence of all is very conclusive that the parties had no purpose whatever to form a partnership, or to give to each other the rights and powers, and subject each other to the obligations of partners. In general this should be conclusive. If parties intend no partnership the courts should give effect to their intent, unless somebody has been deceived by their acting or assuming to act as partners; and any such case must stand upon its peculiar facts, and upon special equities.

It is nevertheless possible for parties to intend no partnership and yet to form one. If they agree upon an arrangement which is a partnership in fact, it is of no importance that they call it something else, or that they even expressly declare that they are not to be partners. The law must declare what is the legal import of their agreements, and names go for nothing when the substance of the arrangement shows them to be inapplicable. But every doubtful case must be solved in favor of their intent; otherwise we should "carry the doctrine of constructive partnership so far as to render it a trap to the unwary." Kent, C. J., in *Post v. Kimberly*, 9 Johns. 470, 504.

We have then a case in which the party it is sought to charge has not held himself out, or suffered himself to be held out as a partner either to the public at large or to the plaintiff, and has not intended to form that relation. He is not therefore a partner by estoppel nor by intent; and if he is one at all, it must be by construction of law.

What then are the *indicia* of partnership in this case; the marks which force that construction upon the court irrespective of the intent of the parties; that in fact control their intent, and give to the parties bringing suit rights which they were not aware of when they sold the supplies?

In the elaborate and able brief which has been presented in behalf of the defendants in error it is conceded that the fact that Beecher was to receive each day a sum "equal to one-third of the gross receipts and gross earnings" for the day, would not necessarily make him a partner. What is claimed is that the fact is "cogent evidence" that Beecher was to participate in the results of the business in a manner that indicated he was a principal in it, and was not receiving compensation for the use of property merely. The view of the law here suggested is undoubtedly correct. There may be a participation in the gross returns that would make the receiver a partner, and there may be one that would not. The question is in what capacity is participation had. Gross returns are not profits and may be large when there are no profits, but it cannot be predicated of either gross returns or profits that the right to participate is conclusive evidence of partnership. This is settled law both in England and in this country at this time, as is fully shown by the authorities cited for the defendants in error. It was recognized in *Hinman v. Littell,* 23 Mich. 484; and in New York, where the doctrine that participation in profits proves partnership has been adhered to most closely, it is admitted there are exceptions. *Eager v. Crawford,* 76 N. Y. 97.

But we quite agree with counsel for defendants in error that no case ought to turn upon the unimportant and mere verbal distinction between the statement in the papers that Beecher was to have a sum "equal to" one-third of the gross receipts and gross earnings, and a statement that he was to have one-third of these receipts and earnings. It is perfectly manifest it was intended he should have one-third of them; that they should be apportioned to him regularly and daily, and not that Williams was to appropriate the whole and pay a sum "equal to" Beecher's proportion when it should be convenient. We can conceive of cases where the difference in phraseology might be important, because it might give some insight into the real intent and purpose of the parties, and throw light upon the question whether that which was to be received, was to be received as partner or only by way of compensation for something supplied to the other, but the intent in this case is too manifest to be put aside by any mere ingenuity in the use of words. *Loomis v. Marshall,* 12 Conn. 69, 79.

In *Cox v. Hickman*, 8 H. L. Cas. 268, 306, Lord Cranworth stated very clearly his views of what should be the test of partnership. "It is often said," he says, "that the test, or one of the tests whether a person not ostensibly a partner, is nevertheless in contemplation of law a partner, is whether he is entitled to participate in the profits. This no doubt is in general a sufficiently accurate test; for a right to participate in profits affords cogent, often conclusive evidence, that the trade in which the profits have been made was carried on in part for or on behalf of the person setting up such a claim. But the real ground of the liability is that the trade had been carried on by persons acting on his behalf. When that is the case, he is liable on the trade obligations, and entitled to its profits, or to a share of them. It is not strictly correct to say that his right to share in the profits makes him liable to the debts of the trade. The correct mode of stating the proposition is to say that the same thing which entitles him to the one makes him liable to the other, namely, the fact that the trade has been carried on in his behalf, *i.e.*, that he stood in the relation of principal towards the persons acting ostensibly as the traders, by whom the liabilities have been incurred, and under whose management the profits have been made." There is something understandable by the common mind in this test; there is nothing artificial or arbitrary about it; it falls in with reason and enables every man to know when he makes his business arrangements whether he runs the risk of extraordinary liabilities contracted without his consent or approval.

It is said, and we believe justly, in *Bullen v. Sharp*, L. R. 1 C. B. 86, that the decision in *Cox v. Hickman* brought back the law of England to what it should be, and Mr. Baron Bramwell, referring to what was declared to be law in *Waugh v. Carver*, 2 H. Bl. 235, expressed the hope "that this notion is overruled," adding that it is "one which I believe has caused more injustice and mischief than any bad law in our books," p. 127. It is certainly overruled very conclusively in Great Britain. *Kilshaw v. Jukes*, 3 B. & S. 847; *Shaw v. Gault*, 16 Irish C. L. R. 357; *Holme v. Hammond*, L. R. 7 Exch. 218; *Ex parte Delhasse*, 7 Ch. Div. 511. And though in New York the courts, hampered somewhat by early cases, have not felt themselves at liberty to adopt and follow the decision in *Cox v. Hickman* to the full extent, it would be easy to show that the American authorities in the main are in harmony with it. Indeed that is very well shown in *Eastman v. Clark*, 53 N. H. 276, where the authorities are collated. It must be admitted, however, that the attempts at an applica-

tion of the test to the complicated facts of particular cases have not been productive of harmonious results.

. . . It is needless to cite other cases. They cannot all be reconciled, but enough are cited to show that in so far as the notion ever took hold of the judicial mind that the question of partnership or no partnership was to be settled by arbitrary tests it was erroneous and mischievous, and the proper corrective has been applied. Except when one allows the public or individual dealers to be deceived by the appearances of partnership when none exists, he is never to be charged as a partner unless by contract and with intent he has formed a relation in which the elements of partnership are to be found. And what are these? At the very least the following: Community of interest in some lawful commerce or business, for the conduct of which the parties are mutually principals of and agents for each other, with general powers within the scope of the business, which powers however by agreement between the parties themselves may be restricted at option, to the extent even of making one the sole agent of the others and of the business.

In this case we have the lawful commerce or business, namely, the keeping of the hotel. We have also in some sense a community of interest in the proceeds of the business, though these are so divided that all the profits and all the losses are to be received and borne by one only. But where in the mutual arrangement does it appear that either of the parties clothed the other with an agency to act on his behalf in this business? We speak now of intent merely, and not of any arbitrary implication of intent which the law, according to some authorities, may raise irrespective of and perhaps contrary to the intent. Could Beecher buy for the business a dollar's worth of provisions? Could he hire a porter or a waiter? Could he discharge one? Could he say the house shall be kept for fastidious guests exclusively and charges made in proportion to what they demand, or on the other hand that the tables shall be plain and cheap so as to attract a greater number? Could he persist in lighting with gas if Williams chose something different, or reject oil if Williams saw fit to use it? Was a servant in the house at his beck or disposal, or could he turn off a guest that Williams saw fit to receive, or receive one that Williams rejected as unfit? In short, what one act might he do or authority exercise, which properly pertains to the business of keeping hotel, except merely the supervision of accounts, and this for the purpose of accounting only? And how could he be principal in a business over which he had absolutely no control? Nor must we forget that

this is not a case in which powers which might otherwise be supposed to exist are taken away or excluded by express stipulation; but they are powers which it is plain from their contract the parties did not suppose would exist, and therefore have not deemed it necessary to exclude.

On the other hand what single act are we warranted in inferring the parties understood Williams was to do for, and as the agent of, Beecher? Not to furnish supplies surely, for these it was expressly agreed should be furnished by Williams and paid for daily. Not to contract debts for water and gas bills and other running expenses, for by the agreement there were to be no such debts. Nor was this an agreement merely that expenses incurred for both were to be met without the use of credit, but it was expressly provided that they were to be the expenses of one party only, and to be met by him from his own means. There was to be no employment of credit, but it was the credit of Williams alone that was in the minds of the parties.

It is difficult to understand how the element of agency could be more perfectly eliminated from their arrangements than it actually was. Beecher furnished the use of the hotel and a clerk to supervise the accounts, and received for so doing one-third the gross returns. It was not understood that he was to intermeddle in any way with the conduct of the business so long as Williams adhered to the terms of his contract. If the business was managed badly Beecher might be a loser, but how could he help himself? He had reserved no right to correct the mistakes of Williams, supply his deficiencies or overrule his judgments. He did indeed agree to take and account for whatever furniture should be brought into the house by Williams, but the bringing any in was voluntary, and so far was Beecher from undertaking to pay to the sellers the purchase price, that on the contrary the value was to be offset against the deterioration of that which Beecher supplied; and it was quite possible that, as between himself and Williams, there might be nothing to pay. And while Williams was not compellable to put any in, Beecher, on the other hand, had no authority to put any in at the cost of Williams.

. . . Our conclusion is that Beecher and Williams, having never intended to constitute a partnership, are not as between themselves partners. There was to be no common property, no agency of either to act for the other or for both, no participation in profits, no sharing of losses. If either had failed to perform his part of the agreement, the remedy of the other would have been a suit at law, and not a bill for an

accounting in equity. If either had died, the obligations he had assumed would have continued against his representatives. We also think there can be no such thing as a partnership as to third persons when as between the parties themselves there is no partnership and the third persons have not been misled by concealment of facts or by deceptive appearances.

The judgment must be reversed with costs and a new trial ordered.

The other Justices concurred.

§354. *From Joseph L. Lewinsohn. Liability to third persons of associates in defectively incorporated associations,* 13 *Mich. L. Rev.* 271.—"While the 'group person' is not created by the law, the law may refuse to recognize it. This is the case in dealing with partnerships and generally with unincorporated companies. Legal recognition of the corporation, however, does not necessarily involve freedom from liability on the part of the members. For example, the stockholders are held personally if the corporate organization is used merely as stratagem to perpetrate fraud.[1] The principal purpose of the statutes authorizing incorporation, nevertheless, is to enable business to be conducted upon a limited liability basis. The statute being for the benefit of the intending incorporators, it would seem that if they should attempt to incorporate but fail substantially to follow the requirements of the statute, they ought logically to be deprived of its protection and relegated to the position they would have occupied if there were no statute and no attempt had been made to incorporate. So, logically the liability of the associates, or their freedom from liability, would depend upon the rules of positive law applicable to the transaction under investigation without reference to the attempted incorporation, and there would be no partnership liability as a matter of course. Indeed the associates might be in an even more favored position, for here as with many legal problems, logic is not the only factor. The associates are, indeed, in a more favored position. While the endeavor to incorporate may have been ineffectual, it must at times be recognized as a fact in much the

[1]*Donovan v. Puttell*, 216 Ill. 629, 1 L. R. A. N. S. 176. See article *Piercing the Veil of Corporate Entity*, by Prof. I. M. Wormser, 12 Col. L. Rev. 496.

same way as the judgment of a court which has been acted upon cannot be entirely disregarded, although the court was without jurisdiction.[2] To put it more concretely, third persons who have dealt with the association on a corporate basis, may be estopped to deny its incorporate existence. The associates may be further protected by the *de facto* doctrine. This doctrine, it will be recalled, prevents collateral attack when there is a law under which the association might have been incorporated and an attempt has been made to become incorporated thereunder, resulting in a colorable corporate organization, coupled with an assumption and exercise in good faith of corporate powers by the associates who are sued as individuals.[3] The unsuccessful attempt to incorporate would not, therefore, penalize the associates, but might on the contrary redound to their advantage. In order then to ascertain whether the associates are personally liable for the obligations of the association, it is necessary to determine first, whether in the absence of an attempted incorporation, they would have been personally liable under the rules of law governing the transaction in question, and secondly, assuming that they would be so liable, whether they are protected either by estoppel or the *de facto* doctrine. Such, it is believed, are the true principles upon which depend the liability of the associates to third persons.

Passing now to the theory of partnership liability, it will not be disputed that the desire of the associates in a defectively incorporated association is not to form a partnership, and that, as between themselves, this desire will control.[4] There is, however, an irreconcilable conflict of opinion upon the question whether this desire of the associates not to form a partnership will prevent them from being held liable as partners at the instance of third persons who have dealt with the association.[5] . . . Before attempting to choose between these conflicting views, let us first recall the essential elements of a partnership (after quoting from the opinion of Mr. Justice Cooley in

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[2]*McClure v. Commonwealth*, 80 Pa. St. 167.

[3]Prof. Warren, 20 Harv. Law. Rev. 464.

[4]*Head v. Owen*, 79 Ia. 23; *Cannon v. Brush El. Co.*, 96 Md. 446, 94 Am. St. Rep. 598.

[5]See cases collected in Notes 11-14, *infra*.

Beecher v. Bush): Clearly then, a defectively incorporated association does not necessarily contain the essential elements of a partnership. Indeed, it is doubtful whether upon approved principles, articles of incorporation would create a partnership, except in the rarest instances.[6] The whole scheme for the conduct of corporate business is almost sure to be inconsistent with the nature of a partnership. The stockholders are given no voice in the management of the business, which is managed by the directors, who do not manage it as agents of the stockholders. The directors stand in a *sui generis* relationship to both the corporation and the stockholders. This relationship partakes of the character of principal, trustee and agent. As to the directors, the stockholders are not principals because they cannot control the discretion of the directors in the management of the corporate affairs. Between themselves, *qua* stockholders, the stockholders do not even stand in a fiduciary relationship for most purposes, much less in the relation of mutual principals and agents. It is hard to see, therefore, how articles of incorporation would create a partnership. It seems to follow that a defectively incorporated association would not be a partnership *ex proprio vigore,* unless it is held one by some arbitrary rule of law.

It might be suggested in this connection that careful draftsmanship may under familiar rules of law of contracts and trusts, irrespective of any attempt to incorporate, place associates in an unincorporated company in a position as regards liability which for practical purposes is very little different from that of stockholders in a corporation. It is believed that much the same result follows an unsuccessful attempt to incorporate.

Addressing ourselves now to the arguments advanced in favor of the theory of partnership liability, we find two: (1) there is no intermediate form of organization between a corporation and a partnership, and (2) the associates would escape liability altogether if they were not held as partners.

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[6]It is not meant to suggest that small, defectively incorporated associations in which all the stock is held by those in active charge of the business might not frequently be conducted as partnerships, and the stockholders held as partners by estoppel. See *Forbes v. Whitmore,* 62 Ark. 229; *Meinhard v. Bedingfield Mer. Co.,* 4 Ga. App. 176.

Is not the argument that if an association is not a corporation, it must be a partnership, sophistical in the extreme? Might it not with equal force be contended that if a partnership is defectively formed, it must be a corporation?—which is, of course, absurd.[7] Is it true that there are no forms of organization known to the law other than the corporation and the partnership? Persons may be members of a voluntary society,[8] tenants in common,[9] or trustees, and *cestuis que trustent*,[10] and as such, conduct their affairs without becoming partners or incurring partnership liability. It is not apparent why a relationship partaking of all these characters may not be created by contract.

Is not the argument that the associates must be held as partners or they will escape liability equally fallacious? This argument seems to be predicated, at least in part, upon the notion

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[7] 25 Harv. Law Rev. 634 n.

[8] "Members of clubs, associations and societies are not partners, though they possess business features and are conducted partly for pecuniary gain. Mr. Burdick in his *Law of Partnership* upon this point says: 'Naturally, therefore, there has been no hesitation on the part of courts in declaring that societies and clubs organized and maintained for the promotion of temperance, *Lafond v. Deems*, 81 N. Y. 507 (1880) ; for the enforcement of the laws, *McCabe v. Goodfellow*, 133 N. Y. 89; 30 Northeastern Reporter, 728 (1892) ; for musical culture among their members, *Danbury Cornet Band v. Bean*, 54 New Hampshire, 524 (1874) ; for the propagation of political, social or religious doctrines, *Richmond v. Judy*, 6 Mo. Appeal 465 (1879) ; or even for mutual protection, *Burt v. Lathrop*, 52 Mich. 106 (1883) ; *Brown v. Stoerkel*, 74 Mich. 269 (1889) ; or insurance, *Cohen v. N. Y. Mutual Life Insurance Co.*, 50 N. Y. 610 (1872)—are not partnerships. even though they may have for one of their objects the accumulation of property to be owned and enjoyed in common. It is not essential to the attainment of the objects which such associations have in view, that their members should severally possess the powers which the law merchant found it necessary to bestow upon each partner, such as the power of alienating firm property or of incurring firm obligations. Hence there is no foundation for a legal inference that the members of such associations possess those powers. On the other hand, it is uniformly held that the property rights and the legal liabilities of the members of these associations depend in the main upon their constitutions and rules, *Cohen v. N. Y. Mutual Life Ins. Co.*, 50 N. Y. 611 (1872).' *Livingston v. Lynch*, 4 Johnson Ch. (N. Y.), 573. 592. See, however, *Cronkrite v. Trexler*, 187 Pa. State, 100." English Ruling Cases, vol. 19, p. 403.

[9] *Robinson Bank v. Miller*, 153 Ill. 244, 46 Am. St. Rep. 883.

[10] *Mayo v. Moritz*, 151 Mass. 481.

that the associates have been guilty of some dereliction in failing to meet the requirements of the incorporation laws, and that they should accordingly be punished. Could anything be further from the mark? The incorporation laws are designed for the protection of the intending incorporators, who, if they fail to bring themselves within the terms thereof, at most, it would appear, lose only the corporate shield. How can failure to follow the statute afford any reason why the associates should be struck down and penalized?

. . . It remains to inquire into the state of the authorities upon the partnership theory. As suggested above, there is much contrariety of opinion upon this question, the greater number of the cases favoring partnership liability.[11] But an analysis of the cases discloses some surprising results. The cases placing the associates' liability upon partnership may be divided into two classes. In the first class it appears affirmatively in each case examined that the associates had participated in or authorized the transaction upon which they were held liable, or that they were directors or officers of the company.[12] In the second class, the report is silent in every case examined upon the question of participation.[13] After a somewhat extended search, the writer has not found a single case in which a non-participating associate, who had not authorized the transaction, was held to a general personal liability. Indeed, whenever the courts have been called upon to consider the case of non-participating associates, it appears that they have affirmatively held them not liable, and this has been true of courts which profess adherence

[11]Cases in support of partnership theory are collected in Notes 12 and 13. Cases *contra* are collected in Note 14.

[12]*Garrett v. Richardson*, 35 Ark. 144; *Forbes v. Whitmore*, 62 Ark. 229; *Meinhardt, etc. v. Bedingfield Mer. Co.*, 4 Ga. App. 176; *Loverin v. McLaughlin*, 161 Ill. 417; (also statutory liability) *Hyatt v. Van Piper*, 105 Mo. App. 664; *Mandeville v. Courtright*, 142 Fed. 97; *Brook v. Day*, 129 Ga. 694; *Eaton v. Walker*, 76 Mich. 579; *Worthington v. Griesser*, 77 N. Y. App. Div. 203 (also statutory liability).

[13]*Perrine et al. v. Levin et al.*, 123 N. Y. Supp. 1007; *Standard Varnish Co. v. Jay*, 149 Ill. App. 25; *Bigelow v. Gregory*, 73 Ill. 197; *Louisiana Nat'l Bank v. Henderson*, 116 La. 413; *Provident Bank v. Saxon*, 116 La. 408.

to the theory of general partnership liability.[14] Is not this a *reductio ad absurdum?* The results reached in the first class of cases may be accounted for on principles of the law of agency, and in the second class the cases are equivocal on their facts. It appears, then, that in the only class of cases where an independent partnership liability might have a *raison d'etre,* the courts have held that there is no liability. In other words, does not the theory of partnership liability as an independent rule of law break down when it comes to be applied?

The partnership theory cannot therefore be sustained upon legal principles, and the authority in support of it is unsatisfactory. The theory is equally repugnant to the requirements of justice and the needs of the business community, for it would subject the modest investor, who has purchased a few shares of stock in a great railroad, financial or industrial corporation which chanced to be defectively organized, to full personal liability for all the debts of the company."

§355. *From the Uniform Partnership Act.*

Sec. 6. (Partnership Defined.)

(1) A partnership is an association of two or more persons to carry on as co-owners a business for profit.

(2) But any association formed under any other statute of this state, or any statute adopted by authority, other than the authority of this state, is not a partnership under this Act, unless such association would have been a partnership in this state prior to the adoption of this Act; but this Act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith.

Sec. 7.—(Rules for Determining the Existence of a Partnership.)—In determining whether a partnership exists, these rules shall apply:

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[14] *Farmers State Bank v. Kucks,* 163 Mo. App. 606; *Lucillo v. Pittelli,* 127 N. Y. Supp. 314; *Fuller v. Rowe,* 57 N. Y. 23; *Central City Sav. Bank v. Walker,* 66 N. Y. 424; *Harrill v. Davis,* 168 Fed. 187, 22 L. R. A. N. S. 1153; *In re Western Bank,* etc., 163 Fed. 713; *Fay v. Noble,* 7 Cush. 188; *Trowbridge v. Scudder,* 11 Cush. 83; *Johnson v. Corser,* 34 Minn. 355; *Rutherford v. Hill,* 22 Ore. 218; *Second Nat'l Bank v. Hall,* 35 Ohio St. 158; *Bank v. Palmer,* 47 Conn. 443; *Churchill v. Thompson Electric Co.,* 119 Ill. App. 430.

(1) Except as provided by Section 16, persons who are not partners as to each other are not partners as to third persons.

(2) Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not of itself establish a partnership, whether such co-owners do or do not share any profits made by the use of the property.

(3) The sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived.

(4) The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment:

(a) As a debt by installments or otherwise,
(b) As wages of an employee or rent to a landlord,
(c) As an annuity to a widow or representative of a deceased partner,
(d) As interest on a loan, though the amount of payment vary with the profits of the business.
(e) As the consideration for the sale of the good-will of a business or other property by installments or otherwise.

§356. *From Samuel Williston. The Uniform Partnership Act.* 63 *Univ. of Pa. Law. Rev.* 196.—"There is perhaps no considerable subject in the law in which a single fundamental but disputed principle makes so marked a difference in the conclusions reached, as is the case in the law of partnership. Very many of the troublesome questions involved in that branch of the law depend for their answer on whether what is called the entity theory of partnership, or the so-called aggregate theory be adopted.

Under the entity theory the partnership is a legal person distinct from the members of the firm. Many of the principles of the law of corporations become applicable and, indeed, the law of partnership would logically become a branch of the law of corporations if this theory were adopted and consistently followed.

Under the aggregate theory, on the other hand, the partners are joint owners of the partnership property, and joint obligors

and obligees of claims due from or to the partnership, though some modifications of the ordinary rules of joint ownership may be necessary because of the particular character of partnership business.

The entity theory has commended itself to not a few experts, notably to the late Dean Ames. The simplicity of the principle and the certainty of the results are unquestionable advantages. The common law theory of joint rights and duties, and of joint ownership of property, is at best a technical and difficult subject. It does not become any less so when the special incidents of partnership are introduced into the case; and it may be urged further on behalf of the entity theory that the law of partnership on the Continent of Europe is based on this theory; and that the subject of partnership is a more troublesome one under the English law than under the Continental law where the entity theory prevails.

On the other hand, however, it is to be said that we cannot escape from our past legal history satisfactorily by a legislative *fiat*. We may trim and pare excrescences, and may on new subjects create wholly new legal ideas by statute, but in subjects with a long past, experience seems to show that it is difficult to adopt fundamentally new ideas. That the English and American law has substantially grown up on what has been called the aggregate theory can hardly be doubted by an impartial student. Results doubtless have been reached, not infrequently, which cannot be satisfactorily explained by the aggregate theory; and statements may be found in judicial opinions that a partnership is an entity, but these are the exception, not the rule.

Moreover, there are special difficulties in the United States in declaring a partnership a legal person. Our states have numberless statutory and constitutional provisions in regard to corporations. That some of these provisions would be applicable to partnerships, if partnerships were a legal entity, seems probable. Unexpected and perhaps unfortunate consequences might follow.

Moreover, if a partnership is to be treated as a quasi-corporation, some system of registration of partnership names and of the members of partnership seems necessary. If the law is to

create new legal persons distinct from the individuals which form them, it must in some way keep track of those persons and define them. Actual persons make themselves sufficiently obvious to the public to make it unnecessary to register them, and so long as actual persons are treated as the owners of partnership property, and as the obligors and obligees of partnership rights, registration is unnecessary.

Dean Ames recognized the necessity of registration and provided in substance in the last draft of the Partnership Act which he prepared, that every partnership must file in the office of the Secretary of State a certificate stating the name of the partnership, the nature of its business, and the name and residence of each partner. On every change of partnership a new certificate is required and no partnership was to be allowed to begin or maintain an action on account of partnership transactions until the prescribed certificate had been filed. Such a provision would not be wholly effective or satisfactory. If the record provided for is to be a final statement of the facts contained in it, there cannot be secret or dormant partners. Moreover, it would be difficult as matter of fact, even with the penal provision suggested, to secure full registration.

But perhaps the most serious objection to the entity theory as a universal principle is its effect upon the rights of creditors. On that theory a creditor's only direct right is against the partnership as such. Any attempt to reach the assets of the individual partner can be made only indirectly by holding him as a contributory to the partnership. The natural means of enforcing such a liability would be by getting judgment first against the partnership, and, on inability to satisfy the judgment from firm assets, to bring a bill in equity or analogous proceeding against the partnership and the individual partner for the purpose of reaching an asset of the firm which could not be reached by ordinary legal process. It seems probable that when persons in England and America deal with a partnership they do not understand that they are dealing with a company or fictitious entity like a corporation, but they understand that they are dealing directly with individuals and in reliance upon individual as well as collective responsibility.

To these reasons for choosing the aggregate theory may be added another practical reason, which is largely based on the reasons already given: Lawyers are distrustful and, as they believe, rightfully distrustful of attempts to change the law root and branch. The mere fact that a proposed act would fundamentally change the legal ideas which have generally been entertained in regard to partnership, would make the law difficult of passage. The Commissioners on Uniform State Laws are seeking as the great reform at which they aim—uniformity—and they cannot sacrifice this object in an attempt to re-write the law in a form which it has never taken in English-speaking countries.

Furthermore, however successful a proposed act may be, as a practical matter the Commissioners on Uniform State Laws must expect, that if it is passed by some states, it will not be passed by others, and they must foresee that for a long period there are likely to be many states which will not adopt the proposed law. If then the law itself is widely different from the common law, the passage of the act in the states which first enacted it will diminish instead of increase uniformity. It may, under some circumstances, be necessary to advocate legislation which will create a wide variance between the laws of those states which adopt the legislation and those states which do not. But other things being equal, or anywhere nearly equal, it is certainly better to follow the general current of the common law.

An extreme illustration of the difficulty of introducing wholly new principles in the law of partnership may be found by considering the provisions of the bankruptcy law. Under the bankruptcy law the old rule of distribution—joint assets primarily to joint creditors, and separate assets primarily to separate creditors—is enacted. If the entity theory should be consistently followed in the Uniform Act, the provisions would be that joint assets went to joint creditors, and individual creditors acquired no right unless after paying all joint creditors there remained an excess. In that case the excess would be distributed among the partners' estates as the equities between the partners might require, and thus would become part of the separate estates

and applicable to the partners' individual debts. But the rights of the partnership creditors would not be confined to the firm assets. The firm as a separate entity would have a right for any deficiency in its assets as compared with its liabilities against the individual partnership estates as contributories and could prove this claim in competition and on an equality with the individual creditor. Whether such a system of distribution is intrinsically better or worse than that provided by the Bankruptcy Act is immaterial. A provision in a state act for distributing partnership assets in a fundamentally different way from that provided in the Federal Act would necessarily and rightly prevent the adoption of the proposed state statute. The substantial rights of the parties could not be made to depend upon whether the partnership was thrown into bankruptcy or the business liquidated without bankruptcy proceedings.

But though the entity theory as a logically consistent theory is not followed in the Uniform Partnership Act, the main advantages of that theory are nevertheless attained; the chief reason for the popularity of the entity view is that it avoids certain difficulties into which the common law has floundered in dealing with the partnership property, especially with reference to creditors.

The two principal difficulties in the administration of partnership law under existing decisions arise from:

1. The right of a partner as joint owner in specific partnership property; and,
2. The settlement of the claims of different classes of creditors when the business is continued but the personnel of the partnership changes.

In the Uniform Partnership Act the first difficulty is solved, not by asserting that the partnership as an entity owns the specific property, but by treating the partners as holding the property by a special kind of tenancy—tenancy in partnership, and defining the incidents of that tenancy in such a way as to meet the difficulties of the problem. Joint tenancy and its incidents were doubtless created by custom, and by the courts, to meet the practical necessities that were felt in co-ownership of

feudal estates. Difficulties have arisen in the law of partnership by trying to fit the incidents of a kind of co-ownership which arose out of different conditions into the situation which arises in partnership. By giving appropriate incidents to tenancy in partnership the draftsman of the act has avoided possibilities of confusion and impractical results, without making a fundamental change in existing law.

Thus the interest of a partner in a specific piece of property belonging to the firm is not subject to attachment in the Uniform Act, nor can a partner assign his interest in such a piece of property except in connection with an assignment of rights of all the partners in that property.

The second difficulty in the administration of partnership law has been met by recognizing the fact that a business may be a single and continuing business though an additional member of the firm may be taken in or one of the original members dropped out. The act provides that when a business is continued without liquidation, though the personnel of the firm conducting the business may change, all the creditors of the different partnerships are creditors of the partnership which continues the business and all have an equal right in the property embarked in the business. Under the existing law that property belongs to the last firm, which results in extreme hardship to the creditors who have extended credit before the last change in the personnel of the firm. Courts have endeavored to modify this hardship by declaring in many cases that the transfer of the property to the last firm was in fraud of the creditors of the preceding firm. The resulting practical situation has been one of extreme doubt where it has been hitherto and it still is extremely difficult to determine the rights of the various creditors.

Minor difficulties also in the application of the aggregate theory have been met. At common law a partner could not convey land or execute any sealed instrument without authority under seal from the other partners. This is changed by giving a partner implied power to execute any instrument appropriate to the business of the firm."

PRACTICE PROBLEMS

(a) A employed B as a clerk upon a salary of $1,200 a year and also borrowed from B, $1000 for five years, agreeing to pay him 10% of the net profits of the business in lieu of interest. Three years afterward A became bankrupt, owing $3,000 in excess of his assets. The debts included the $1,000 borrowed of B and an unpaid balance of $500 on B's salary. B seeks to prove these two claims against A's estate. A's other creditors object to this proof and have also sued him as a partner with B. What are the rights and liabilities of B?

(b) A, who owned a summer hotel, leased it to B under an agreement whereby the lessor was to receive one-half of the net profits of the business as rent. C entered into a contract with B whereby it was agreed that C should serve as general manager of the hotel and that all profits and losses of B's venture should be shared equally by C and B. The venture was wholly unsuccessful. Are either A or C liable for the debts incurred in the business?

D. In Corporations

§357. *The Organization of Corporations.*—In organizing a corporation the following problems require careful attention:

(a) The relative merits of the corporate and other forms of organization for the particular business in hand under the given conditions;

(b) The choice of a state within which to incorporate.

(c) Capitalization and control.

The advantages of incorporation are succinctly stated in the case of *Flint v. Stone Tracy Co.,* 220 U. S. 107, as follows:

> The continuity of the business without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted which do not exist when the same business is conducted by individuals or partnerships.

The imposition of various taxes on corporations and also regulations insuring publicity have in recent years caused some business men to revert to unincorporated associations to carry out their purposes. Some of these associations are organized

under the provisions of elaborate trust indentures, and have transferable shares and elaborate provisions for limitation of the liability of the shareholders. Although the ingenuity of lawyers has made these organizations resemble closely in their important features business corporations, it is a disadvantage that the law on some of the most important questions raised by these elaborate trust indentures is still in an uncertain condition, whereas the law of corporations is in most states now very well crystallized.[1]

The advantages of a partnership over a corporation are: (1) It is a personal relation—no new co-partner can be thrust upon one who is in a partnership; (2) the unlimited liability of individual partners helps the credit of the firm; (3) every partner can bind the firm, whereas in a corporation there is a concentration of management; (4) no persons other than the partners have a right to know anything concerning the business.

Of course by means of special contracts or by-laws some of the features of a partnership may be engrafted on a corporation, and to a limited extent the converse is true.

Assuming that the business is one likely to be served best by the corporate form, it is frequently an important question where to incorporate. Of course, if the business is to be located altogether in a single state, any advantage offered by another state must be weighed carefully against the possible disadvantage of being a foreign corporation, and as such subject to special regulations in the state where the bulk of the business is transacted, for a state has the power to exclude foreign corporations or to dictate the terms under which they shall be admitted. No state will allow another to spawn its corporations for its own advantage and to the disadvantage of the state within which the corporation operates. But assuming that the business is interstate in its nature, there is sufficient lack of uniformity[2] to make

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[1]See Wrightington, *The Law of Unincorporated Associations;* Sears, *Declarations of Trust as Effective Substitutes for Incorporation;* Report of the Massachusetts Special Commission to investigate Voluntary Associations (Jan. 4, 1913); Guy A. Thompson, *Business Trusts as Substitutes for Business Corporations*, 1920.

[2]The Commissioners on Uniform State Laws have a uniform incorporation act under consideration.

it desirable in the present state of the law to inquire with reference to the following points in the states under consideration: Expenses, both initial and annual franchise taxes; limitations upon purposes, names, incurring of debts, especially in the modified forms of bond issues and preferred stock; the rules with reference to capitalization, especially the limitations upon issuing stock for goods and services; the rules as to stockholders' liability; the records required, and the right of stockholders or representatives of the public to have access to these records; the general state of the corporation and other business laws of the commonwealth in question; requirements as to place of meetings and records to be kept within the state of incorporation; the taxation of stock and income from stock; taxation on transfer and inheritance of stock; specific laws with reference to the type of business sought to be incorporated.

The problem of capitalization is not primarily a legal problem, for even if the law seeks to make the original investment accord in the first instance with the par value of the shares, no amount of legislation can prevent a discrepancy arising, as the business prospers or fails, between the par value and the actual value. Furthermore the business public is not misled by nominal values. In fact, it is difficult to see what function is fulfilled by capitalization that would not be accomplished by a division of the capital stock into units not designated in dollars. Nevertheless a large part of the public is so firmly convinced that many evils flow from the "watering" of stock, that legislation will probably be aimed for some time at maintaining some sort of relation between the amount of capital invested and the nominal capitalization of a corporation. It becomes necessary therefore to take into consideration at the outset the amount of capital that the business will require at the seasons of greatest expansion, for in some states even the power to borrow is measured in terms of the original capitalization. Furthermore changes in the capitalization are not easily accomplished in the face of a determined minority—sometimes even a minority consiting of one. Consequently control over the corporation cannot be entirely divorced from the ownership of the capital actually used in the business, though some leeway is permitted

in the matter of creating preferred stock to a limited amount without voting power.

With these problems decided, the matter of incorporating under modern statutes is so highly standardized in each of the states that there is little for the incorporators to do but to sign and acknowledge the prescribed form of articles of incorporation and file them with the officer designated by the statute, which constitutes the blanket charter of all corporations, since states have given up the practice of incorporating business organizations by separate acts of the legislature. These articles generally are in effect an acceptance of the benefit of the statute and in form consist of a statement of the name, purpose, place of business and capitalization of the proposed corporation. Many states require in addition a certificate that a percentage of the capital stock has been subscribed as a prerequisite to doing business. At the first meeting of the incorporators, by-laws are adopted and directors elected. Most states furnish official blanks for the preliminary steps of organization.

§358. *From Edward H. Warren. De Facto Corporations.* 20 *Harv. L. Rev.* 456.—"Assume the contention to be that the existence of an alleged corporation cannot be attacked collaterally, if the assumption of the right to be a corporation is made under peculiarly extenuating circumstances. Assume further that these extenuating circumstances are: (1) that an attempt to incorporate has been made resulting in a colorable corporate organization; (2) that there was a law authorizing the formation of such a corporation as was attempted; (3) that there has been user of some of the powers which such a corporation would possess; and (4) that the persons seeking to prevent collateral attack acted in good faith. Under such circumstances, why should not the courts refuse to allow any one but the state to call attention to any slip that was made in the attempt to form the corporation? At first blush the doctrine seems harmless and commendable—to be intended merely to save examination into all the details of the formation of corporations.

In answer. In the first place, it is to be noted that, if the existence of a corporation is only collaterally in issue, it is well settled that proof of facts sufficient to satisfy the requirements of the *de facto* doctrine is sufficient to make a *prima facie* case. In the second place, it is to be noted that most failures to conform strictly to statutory provisions are not fatal to the formation of the corporation. (a) If a provision of the statute has not been exactly followed, the court may hold that there has been substantial compliance. (b) If some provision of the statute has not been followed at all, the court may hold such provision to be merely directory. (c) If some mandatory provision has not been followed at all, the court may nevertheless hold that performance of the acts specified in such provision was not intended to be a condition precedent to the existence of the corporation—that non-performance was intended at most to be a ground for declaring the corporate existence forfeited. In all these cases the associates gain authority to act as a corporation.

We are dealing, therefore, only with a case where the court, on a sound construction of the statutes, finds the intent of the legislature to have been that performance of a certain act should be a condition precedent to incorporation. The legislature might, indeed, have authorized the formation of two kinds of corporations, one good against the world, and one good against all but the state. But such statutes are rare. The legislature has authorized the formation only of a corporation good against the world. It has declared that a certain act shall be performed before any such corporation shall come into existence. The act has not been performed. Is it proper, notwithstanding, for the court to allow the assertion of rights dependent upon incorporation?

It is not for the court to create a corporation. The franchise to be a corporation can be granted only by the legislature. Is the court not to respect this division of powers, but to make itself, *de facto,* a legislature?

It may well be answered that it is not for the courts to create public officers any more than to create corporations; and yet the doctrine of *de facto* public officers is well established,

and a doctrine of *de facto* corporations for the benefit of third persons has also found its place in the law.

The question therefore reduces itself at last to a question of judgment. Are there considerations of public policy so urgent as to make it proper for the courts to allow persons to assert the right to be a corporation even when, on a sound construction of the legislative enactments, they have no such right? Considerations tending to an affirmative answer are that the courts should save time by refusing to go into the details of incorporation; and that they should encourage the use of the corporate device by establishing a consolation doctrine to the effect that, if persons try to form a corporation and pretty nearly succeed, they shall have pretty nearly as many rights as though they had succeeded. Considerations tending to a negative answer are that the courts should not, directly or indirectly, take to themselves powers belonging to the legislature, and that it is anomalous to bridge a legal gap even in favor of a person who has made an expenditure in good faith."

§359. *From Edward H. Warren. Collateral Attack on Corporation.* 21 *Harv. L. Rev.* 305.—"Viewing the subject as a whole, it is seen that whether or not collateral attack is to be permitted depends not so much on logical deductions as on the exercise of a sound judgment. Opposing considerations must be weighed. The law, therefore, cannot be pictured in bright lines. Some large features, however, emerge. (1) Collateral attack should be permitted to a stranger to whose prejudice the associates seek to assert a right dependent upon incorporation, —and this whether there are the technical requisites of the *de facto* doctrine, or not. (2) The associates should not be shielded from full liability where their legal incorporation failed for some reason more serious than an informality or irregularity in their organization. (3) These effective checks by collateral attack being established, the courts may, in many other instances, properly deny such attack—and this whether there are the technical requisites of the *de facto* doctrine, or not. Thus, notably, where A seeks to avoid liability on the ground that there was no law under which the associates could have obtained authority for their corporate action.

CHAPTER XII

OPERATION OF RELATIONS AS TO OUTSIDERS

A. In Agency

§360 *CAWTHORN v. LUSK.*

Supreme Court of Alabama, 1892. [97 *Ala.* 674.]

HEAD, J.: The action is brought by appellants to recover damages for the breach of an agreement for the sale of 800 sacks of dried grapes, made by Stollenwerck & Co., as agents of defendants. The case was tried by the city court without a jury, and judgment rendered for defendants. The sale of the grapes by Stollenwerck & Co. at 3½ cents per pound f. o. b. to be delivered in September and October following, and that the intention and understanding of these parties was that the sale was a finality; also that defendants refused to deliver the grapes—are uncontroverted facts. The only disputed question of fact relates to the authority of Stollenwerck & Co. to bind defendants by the contract of sale, without first submitting it for their acceptance or rejection.

Defendants, who reside and are doing business in California, while conceding that Stollenwerck & Co. are their agents or brokers in Birmingham, Ala., to sell dried fruits, claim that they were only authorized to make contracts of sale subject to confirmation. That such is the nature and extent of their general authority is shown by the letter of instructions, dated July 9, 1890, sent by defendants to them, and by the general custom of the trade, of which plaintiffs, having been engaged in the same business in Birmingham for several years, are chargeable with notice.

The question then arises whether authority, express or implied, was subsequently conferred to sell the grapes at 3½ cents per pound. Plaintiffs claim that such authority is implied from a telegram sent by defendants to Stollenwerck & Co., when interpreted by the custom and usage of the trade. The law presumes that when a commercial agency is to be exer-

cised, in the absence of limitation or prohibition, it is to be conducted in the mode authorized and justified by the customs and usages of such trade or business. In *Guesnard v. Railroad Co.,* 76 Ala. 453, this doctrine is asserted as follows: "Where a mercantile agency is to be executed at a particular place, the principal who employs the agent is presumed to consent that he may execute it, in the absence of particular instructions, according to the general custom and usage relating to that kind of trade or business, whatever it may be. The law implies that he gives his consent for his agent to act as all other similar agents who are honest and diligent are accustomed to do; and it is immaterial, as a general rule, whether the principal is informed as to such customs and usages or not." It is true that, when an agency is created by a written instrument, the nature and extent of the authority must be ascertained from the instrument itself, and cannot be enlarged by parol proof. This rule is not violated by the admission of proof of the usages of trade. They are admitted, not for the purpose of enlarging, but of interpreting the powers actually given. Says Judge Story: "The known usages of trade and business often become the true exponents of the nature and extent of an implied authority." Story, *Ag.* §96; *Wheeler v. McGuire,* 86 Ala. 398, 5 South. 190, 2 L. R. A. 808.

The telegram referred to was sent by defendants to Stollenwerck & Co. July 18, 1890, and is as follows: "Cannot offer dried grapes below 3½ f. o. b. Have advanced to 3¾." This telegram was in response to one sent by Stollenwerck & Co. to defendants the day before, of which the following is a copy: "Ormsby offering dried grapes 4.70. Can't you let us meet that price?" The evidence shows a custom or usage of the trade to the effect that a telegram sent by the principal to the broker giving a price, without any stipulation in the telegram that sales made at such price shall be subject to confirmation by the principal, is authority to the broker to sell finally and unconditionally at that price, no matter what the prior instructions were. This custom is testified to by two witnesses, whose testimony is uncontradicted. True, Isadore Jacobs, who represents defendants, testifies: "None of our letters or telegrams to Stollenwerck & Co. instructed them to sell dried grapes, our instructions being to take orders for dried grapes subject to confirmation; and, even if letters or telegrams had been sent instructing brokers to sell, it would be understood that they could only sell subject to confirmation, unless specially stated, 'You may sell without confirmation.'"

It will be observed that the witness does not deny the existence of the custom, but only testifies to the private understanding between defendants and their brokers. Such private understanding is not binding on plaintiffs, unless communicated to them. There is no pretense that it was communicated; on the contrary, the evidence shows that the telegram of July 18, 1890, was shown to plaintiffs as Stollenwerck & Co.'s authority to make a final and unconditional sale. We find from the evidence that there was such custom. Considering the telegram in connection with the one to which it was a response, it might well be contended, without reference to the custom, that it was at least implied authority to sell dried grapes at 3½ cents per pound f. o. b. But it is not necessary to so find. There being no instruction or stipulation in the telegram that sales at that price are subject to confirmation, Stollenwerck & Co. were thereby authorized under the custom to sell finally and unconditionally the grapes to plaintiffs, and defendants are bound by the contract of sale to the same extent as if they had sold the grapes. *Herring v. Skaggs,* 62 Ala. 180, 34 Am. Rep. 4.

The measure of damages is the difference between the price which plaintiffs agreed to pay for the grapes, including cost of transportation to Birmingham, and the market price at Birmingham at the time of delivery, with interest. Under the evidence, we assess the plaintiffs' damages at the sum of $945. The judgment of the city court is reversed, and a judgment will be entered in this court in favor of the plaintiffs for said sum of $945, together with the costs in this court and the city court.

This opinion, except as to assessment of damages, was prepared by the late Justice CLOPTON. Reversed and rendered.

§361. *Trade Usage and the "Apparent Scope" of Authority.*—Granting the principle of law, that secret instructions cannot affect the authority of an agent, there still remains the question: What is the apparent scope of the authority of a traveling salesman? This, of course, is a business question. In many trades, the so-called "drummer" is known to have no power to make a binding contract. His function is simply to solicit orders which are offers subject to be accepted or rejected by his employers. The importance of trade usage in fixing the scope of such agencies is illustrated in the foregoing case.

§362 *HERRING v. SKAGGS.*

Supreme Court of Alabama, 1878. [62 *Ala.* 180.]

[Action for damages for breach of a warranty by a sales agent that a safe was burglar proof. The safe had been broken open and rifled of a sum of money and other valuables.]

STONE, J.: In *Skinner v. Gunn,* 9 Port. 305, speaking of the power of an agent to bind his principal, this court said: "The power in this case is to sell and convey the negro in the name of the plaintiff, and the agent must, as an incident of that power, and in the absence of any prohibition, have the right to warrant the soundness of the slave, as that is a usual and ordinary stipulation in such contracts, and must therefore be implied to effectuate the object of the power." The court, in the same case, had said, "An authority to do an act must include power to do everything usual and necessary to its accomplishment." This doctrine was reaffirmed in *Gaines v. McKinley,* 1 Ala. 446, and in *Cocke v. Campbell,* 13 Ala. 286. It will be observed that, in these cases, the court states, as matter of law, that power given to sell a slave carried with it power to warrant his soundness in the absence of prohibition. A similar principle is found in the books, in reference to the power of an agent to bind his principle, by warranty of the soundness of a horse he is authorized to sell. It is a "usual and ordinary stipulation in such contracts," say the courts. Perhaps the custom of such warranties is so general, and has prevailed so long, that it has come to be treated as judicial knowledge. Certainly it was not intended to be affirmed, that an agent with general powers of sale, has unlimited power to bind his principal by any and every stipulation the various phases of traffic may be made to assume. If so, the words, "in the absence of prohibition," found in the case of *Skinner v. Gunn, supra,* are meaningless and powerless.

In the case of *Fisher v. Campbell,* 9 Port. 210, a question arose on the implied power of an agent to bind his principal. That was the case of a non-resident planter, whose overseer in charge made purchases of supplies for the plantation and hands. It was proved that the employer had given the overseer instructions to purchase pork for his slaves from a particular mercantile house at Montgomery, with whom he had made arrangements for that purpose, and had given him no directions to buy anywhere else, nor had he any authority to purchase from any other person. The plantation was in Lowndes county, and, the roads being bad, the overseer purchased pork in his own county, much nearer to him, and at

Montgomery prices. Commenting on a charge requested by plaintiffs, and refused by the court below, this court said, "The last branch of the charge is stated as a corollary from the preceding propositions; 'that any special directions given to McMay [the overseer] by the defendant, as to the place of purchasing, was wholly immaterial as to this purchase, unless from the evidence they were satisfied that plaintiffs were informed at the time of such sale of such special directions; and that without this information, the plaintiffs would be entitled to recover, if the proof was fully made out.' We understand the law to be the exact converse of this proposition. When a person deals with one who professes to be the agent of another person, the person contracting with him is bound to know the extent of his authority." See, also, *McCrary v. Slaughter*, 58 Ala. 230.

We are not prepared to assent to the doctrine, in unlimited sense, that a general agent to sell has, by virtue thereof, the power to bind his principal by every species of warranty a purchaser may exact. In Benjamin on *Sales*, §624, is the following language: "Warranties are sometimes given by agents, without express authority to that effect. In such cases the question arises as to the power of an agent, who is authorized to sell, to bind, his principal by a warranty. The general rule is, as to all contracts including sales, that the agent is authorized to do whatever is usual to carry out the object of his agency, and it is a question for the jury to determine what is usual. If in the sale of the goods confided to him, it is usual in the market to give a warranty, the agent may give that warranty in order to effect a sale." We fully approve and adopt this language of this very accurate writer. We do not intend, however, to overturn the doctrine declared in *Skinner v. Gunn*, and *Cocke v. Campbell, supra.* As a general rule, the agent has power to do whatever is usual—to enter into such express stipulations as are usual and customary—in effecting such sales.

What stipulations are usual and customary in effecting such sales is not always matter of judicial knowledge. It is declared in the sales of slaves and horses to be within the knowledge of the court that it is usual to give warranties. It can not be affirmed that such custom exists in the sale of all chattels. Generally, and we hold in a sale like the present, "it is a question for the jury to determine what is usual." This, in the absence of express authority in the agent to warrant; for if the agent had such express authority, then his act is the act of his principal. And, in the absence of express authority, the

question arises, and it is one for the jury, whether such warranty is customary in the sale of safes. If the jury, on the evidence, find there was such custom, then the principal is bound, "in the absence of prohibition" resting on the agent, and brought to the knowledge of the purchaser, to the same extent as if the principal had himself given the warranty. On the other hand, if there was no such authority given, and no such custom found to exist, then the principal would not be bound. True, if the principal ratified the act of such agent, although the act itself had been unauthorized, this would bind the principal. But the receipt of the purchase money would have no such effect, unless received or retained with knowledge that the agent had given the warranty.

The sale in the present case was made by an agent. In the absence of proof of express authority to warrant, it was incumbent on the plaintiff to show a custom in the sale of safes, to warrant them as burglar proof. Either the express authority, or the authority implied from such proven custom, would constitute the act of the agent the act of the principal; but the law does not imply the authority from the fact that Stewart, who conducted the sale, was a general agent. The third count of the complaint avers that the defendants "did employ an agent, and authorized him to sell such safes, and did hold him forth to the public residing in and about the town of Talladega, Alabama, and elsewhere, as their general agent for the sale of iron safes." This is the entire averment of authority, and we hold it insufficient. It should have been averred that the agent had authority to make the warranty. Being averred, proof of express authority, or custom to warrant, would have sustained the averment. The third count is insufficient, and the demurrer to it should have been sustained.

Under the principles above declared, it became a material inquiry whether Stewart had express authority to warrant the safe as burglar-proof. He should have been permitted to prove he had not such express authority. True, this would not necessarily exonerate the defendants. It would bear on only one phase of the inquiry; for, if such warranties are usual and customary in the sale of iron safes, then even a prohibition of authority to the agent would amount to nothing, unless knowledge of such prohibition was carried home to the purchaser before the sale was consummated. So, if the published descriptive pamphlet with which the agent was furnished, tended to disclose what classes of safes were, and what were not represented as burglar-proof, and such pamphlet was exhibited to the purchaser pending the negotiation, then that pamphlet

should have been allowed to go to the jury, as shedding some light on the controverted question of warranty *vel non* . . . .

Reversed and remanded.

§363 *WATTEAU v. FENWICK.*

Queen's Bench Division, 1892. [1893, 1 *Q. B.* 346.]

Appeal from the decision of the county court judge of Middlesborough.

From the evidence it appeared that one Humble had carried on business at a beerhouse called the Victoria Hotel, at Stockton-on-Tees, which business he had transferred to the defendants, a firm of brewers, some years before the present action. After the transfer of the business, Humble remained as defendants' manager; but the license was always taken out in Humble's name, and his name was painted over the door. Under the terms of the agreement made between Humble and the defendants, the former had no authority to buy any goods for the business except bottled ales and mineral waters; all other goods required were to be supplied by the defendants themselves. The action was brought to recover the price of goods delivered at the Victoria Hotel over some years, for which it was admitted that the plaintiff gave credit to Humble only; they consisted of cigars, bovril, and other articles. The learned judge allowed the claim for the cigars and bovril only, and gave judgment for the plaintiff for £22 12*s.* 6*d.* The defendants appealed.

1892. *Finlay,* Q. C. (*Scott Fox* with him), for the defendants. The decision of the county court judge was wrong. The liability of a principal for the acts of his agent, done contrary to his secret instructions, depends upon his holding him out as his agent—that is, upon the agent being clothed with an apparent authority to act for his principal. Where, therefore, a man carries on business in his own name through a manager, he holds out his own credit, and would be liable for goods supplied even where the manager exceeded his authority. But where, as in the present case, there is no holding out by the principal, but the business is carried on in the agent's name, and the goods are supplied on his credit, a person wishing to go behind the agent and make the principal liable must show an agency in fact.

[LORD COLERIDGE, C. J.: Cannot you, in such a case, sue the undisclosed principal on discovering him?]

Only where the act done by the agent is within the scope of

his agency; not where there has been an excess of authority. Where any one has been held out by the principal as his agent, there is a contract with the principal by estoppel, however much the agent may have exceeded his authority; where there has been no holding out, proof must be given of an agency in fact in order to make the principal liable.

Boydell Houghton, for the plaintiff. The defendants are liable in the present action. They are in fact undisclosed principals, who instead of carrying on the business in their own names employed a manager to carry it on for them, and clothed him with authority to do what was necessary to carry on the business. The case depends upon the same principles as *Edmunds v. Bushell,* L. R. 1 Q. B. 97, where the manager of a business which was carried on in his own name with the addition "and Co.," accepted a bill of exchange, notwithstanding a stipulation in the agreement with his principal that he should not accept bills; and the Court held that the principal was liable to an indorsee who took the bill without any knowledge of the relations between the principal and agent. In that case there was no holding out of the manager as an agent; it was the simple case of an agent being allowed to act as the ostensible principal without any disclosure to the world of there being any one behind him. Here the defendants have so conducted themselves as to enable their agent to hold himself out to the world as the proprietor of their business, and they are clearly undisclosed principals. *Ramazotti v. Bowring,* 7 C. B. (N. S.) 851. All that the plaintiff has to do, therefore, in order to charge the principals, is to show that the goods supplied were such as were ordinarily used in the business—that is to say, that they were within the reasonable scope of the agent's authority.

[He also cited *Yorkshire Banking Co. v. Beatson,* 4 C. P. D. 204; 5 C. P. D. 109.]

Finlay, Q. C., in reply, cited *Summers v. Solomon,* 7 E. & B. 879. Cur. adv. vult. Dec. 12. LORD COLERIDGE, C. J.: The judgment which I am about to read has been written by my brother Wills, and I entirely concur in it.

WILLS, J.: The plaintiff sues the defendants for the price of cigars supplied to the Victoria Hotel, Stockton-upon-Tees. The house was kept, not by the defendants, but by a person named Humble, whose name was over the door. The plaintiff gave credit to Humble, and to him alone, and had never heard of the defendants. The business, however, was really the defendants', and they had put Humble into it to manage it for them, and had forbidden him to buy cigars on credit. The

cigars, however, were such as would usually be supplied to and dealt in at such an establishment. The learned county judge held that the defendants were liable. I am of opinion that he was right.

There seems to be less of direct authority on the subject than one would expect. But I think that the Lord Chief Justice during the argument laid down the correct principle, *viz.;* once it is established that the defendant was the real principal, the ordinary doctrine as to principal and agent applies—that the principal is liable for all the acts of the agent which are within the authority usually confided to an agent of that character, notwithstanding limitations, as between the principal and the agent, put upon that authority. It is said that it is only so where there has been a holding out of authority—which cannot be said of a case where the person supplying the goods knew nothing of the existence of a principal. But I do not think so. Otherwise, in every case of undisclosed principal, or at least in every case where the fact of there being a principal was undisclosed, the secret limitation of authority would prevail and defeat the action of the person dealing with the agent, and then discovering that he was an agent and had a principal.

But in the case of a dormant partner it is clear law that no limitation of authority as between the dormant and active partner will avail the dormant partner as to things within the ordinary authority of a partner. The law of partnership is, on such a question, nothing but a branch of the general law of principal and agent, and it appears to me to be undisputed and conclusive on the point now under discussion.

The principle laid down by the Lord Chief Justice, and acted upon by the learned county court judge, appears to be identical with that enunciated in the judgments of Cockburn, C. J., and Mellor, J., in *Edmunds v. Bushell,* L. R. 1 Q. B. 97, the circumstances of which case, though not identical with those of the present, come very near to them. There was no holding out, as the plaintiff knew nothing of the defendant. I appreciate the distinction drawn by Mr. Finlay in his argument, but the principle laid down in the judgments referred to, if correct, abundantly covers the present case. I cannot find that any doubt has ever been expressed that it is correct, and I think it is right, and that very mischievous consequences would often result if that principle were not upheld.

In my opinion this appeal ought to be dismissed with costs.

Appeal dismissed.

§364. *Standardized "Apparent Scope."*—Is it not a contradiction of terms to speak of the "apparent scope" of the authority vested by an undisclosed principal? Yet that is the theory on which the above case seems to proceed. The difficulty arises from the use of the word "apparent." We are really dealing with an external standard which the law has developed for gauging the usual scope of the authority of certain classes of agents. The principle laid down in the case is significant in the gauging of the liabilities of dormant partners.

§365 *MEHITABEL HUNTINGTON v. KNOX.*

Supreme Judicial Court of Massachusetts, 1851. [7 *Cush.* 371.]

SHAW, C. J.: This action is brought to recover the value of a quantity of hemlock bark, alleged to have been sold by the plaintiff to the defendant, at certain prices charged. The declaration was for goods sold and delivered, with the usual money counts. The case was submitted to a referee by a common rule of court, who made an award in favor of the plaintiff, subject to the opinion of the court on questions reserved, stating the facts in his report, on which the decision of those questions depends.

The facts tended to show that the bark was the property of the plaintiff; that the contract for the sale of it was made by her agent, George H. Huntington, by her authority; that it was made in writing by the agent, in his own name, not stating his agency, or naming or referring to the plaintiff, or otherwise intimating, in the written contract, that any other person than the agent was interested in the bark.

Objection was made, before the referee, to the admission of parol evidence, and to the right of the plaintiff to maintain the action in her own name. The referee decided both points in favor of the plaintiff, holding that the action could be maintained by the principal and owner of the property, subject to any set-off or other equitable defence, which the buyer might have, if the action were brought by the agent.

The court are of opinion that this decision was correct upon both points. Indeed they resolve themselves substantially into one; for *prima facie*, and looking only at the paper itself, the property is sold by the agent, on credit; and in the absence of all other proof, a promise of payment to the seller would be implied by law; and if that presumption of fact can

be controverted, so as to raise a promise to the principal by implication, it must be by evidence *aliunde,* proving the agency and property in the principal.

It is now well settled by authorities, that when the property of one is sold by another, as agent, if the principal give notice to the purchaser, before payment, to pay to himself, and not to the agent, the purchaser is bound to pay the principal, subject to any equities of the purchaser against the agent.

When a contract is made by deed under seal, on technical grounds, no one but a party to the deed is liable to be sued upon it; and therefore, if made by an agent or attorney, it must be made in the name of the principal, in order that he may be a party, because otherwise he is not bound by it.

But a different rule, and a far more liberal doctrine, prevails in regard to a written contract, not under seal. In the case of *Higgins v. Senior,* 8 Mees. & Welsb. 834, it is laid down as a general proposition, that it is competent to show that one or both of the contracting parties were agents for other persons, and acted as such agents in making the contract of sale, so as to give the benefit of the contract, on the one hand, to, and charge with liability of the other, the unnamed principals; and this whether the agreement be or be not required to be in writing, by the Statute of Frauds. But the court mark the distinction broadly between such a case and a case where an agent, who has contracted in his own name, for the benefit, and by the authority of a principal, seeks to discharge himself from liability, on the ground that he contracted in the capacity of an agent. The doctrine proceeds on the ground that the principal and agent may each be bound; the agent, because by his contract and promise he has expressly bound himself; and the principal, because it was a contract made by his authority for his account. *Paterson v. Gandasequi,* 15 East, 62; *Magee v. Atkinson,* 2 Mees. & Welsb. 440; *Trueman v. Loder,* 11 Ad. & El. 589; *Taintor v. Prendergast,* 3 Hill, 72; *Edwards v. Golding,* 20 Vt. 30. It is analogous to the ordinary case of a dormant partner. He is not named or alluded to in the contract; yet as the contract is shown in fact to be made for his benefit, and by his authority, he is liable.

So, on the other hand, where the contract is made for the benefit of one not named, though in writing, the latter may sue on the contract, jointly with others, or alone, according to the interest. *Garrett v. Handley,* 4 B. & C. 664; *Sadler v. Leigh,* 4 Campb. 195; *Coppin v. Walker,* 7 Taunt. 237; Story on *Agency,* §410. The rights and liabilities of a principal, upon a written instrument executed by his agent, do not de-

pend upon the fact of the agency appearing on the instrument itself, but upon the facts: 1, that the act is done in the exercise, and 2, within the limits, of the powers delegated; and these are necessarily inquirable into by evidence. *Mechanics' Bank v. Bank of Columbia,* 5 Wheat. 326.

And we think this doctrine is not controverted by the authority of any of the cases cited in the defendant's argument. *Hastings v. Lovering,* 2 Pick. 214, was a case where the suit was brought against an agent, on a contract of warranty upon a sale made in his own name. The case of the *United States v. Parmele,* Paine, 252, was decided on the ground that, in an action on a written executory promise, none but the promisee can sue. The court admit that, on a sale of goods made by a factor, the principal may sue.

This action is not brought on any written promise made by the defendant; the receipt is a written acknowledgment, given by the plaintiff to the defendant, of part payment for the bark, and it expresses the terms upon which the sale had been made. The defendant, by accepting it, admits the sale and its terms; but the law raises the promise of payment. And this is by implication, *prima facie,* a promise to the agent; yet it is only *prima facie,* and may be controlled by parol evidence that the contract of sale was for the sale of property belonging to the plaintiff, and sold by her authority to the defendant, by the agency of the person with whom the defendant contracted.

We are all of opinion that the provisions of Rev. Sts. c. 28, §201, do not apply to the sale of bark, as made in this case.

Judgment on the award for the plaintiff.

§366 *KEIGHLEY, MAXSTEAD & CO. v. DURANT.*

House of Lords, 1901. [1901, *A. C.* 240.]

LORD MACNAGHTEN: . . . As a general rule, only persons who are parties to a contract, acting either by themselves or by an authorized agent, can sue or be sued on the contract. A stranger cannot enforce the contract, nor can it be enforced against a stranger. That is the rule, but there are exceptions. The most remarkable exception, I think, results from the doctrine of ratification as established in English law. That doctrine is thus stated by Tindal, C. J., in *Wilson v. Tumman* (1843), 6 Mann. & G. at p. 242, 6 Scott, N. R. 894, 1 Dowl. & L. 513, 12 L. J. C. P. N. S. 306: "That an act done, *for another,* by a person, not assuming to act for himself, but for such other person, though without any precedent authority whatever, becomes the act of the principal, if subsequently

ratified by him, is the known and well-established rule of law. In that case the principal is bound by the act, whether it be for his detriment or his advantage, and whether it be founded on a tort or on a contract, to the same effect as by, and with all the consequences which follow from, the same act done by his *previous* authority.'' And so by a wholesome and convenient fiction, a person ratifying the act of another, who, without authority, has made a contract openly and avowedly on his behalf, is deemed to be, though in fact he was not, a party to the contract. Does the fiction cover the case of a person who makes no avowal at all, but assumes to act for himself and for no one else? If Tindal, C. J.'s statement of the law is accurate, it would seem to exclude the case of a person who may intend to act for another, but at the same time keeps his intention locked up in his own breast; for it cannot be said that a person who so conducts himself does assume to act for anybody but himself. But ought the doctrine of ratification to be extended to such a case? On principle I should say certainly not. It is, I think, a well-established principle in English law that civil obligations are not to be created by, or founded upon, undisclosed intentions. That is a very old principle.

LORD LINDLEY: My Lords, I do not propose to trouble the House by stating the facts or by examining in detail the numerous authorities cited in the course of the argument. I propose to confine my observations to what appear to me to be the real difficulties in the case, and to the legal doctrines involved in it.

So much turns on the position of undisclosed principals that I will first say a few words about them.

The explanation of the doctrine that an undisclosed principal can sue and be sued on a contract made in the name of another person with his authority is, that the contract is in truth, although not in form, that of the undisclosed principal himself. Both the principal and the authority exist when the contract is made; and the person who makes it for him is only the instrument by which the principal acts. In allowing him to sue and be sued upon it, effect is given, so far as he is concerned, to what is true in fact, although that truth may not have been known to the other contracting party.

At the same time, as a contract is constituted by the concurrence of two or more persons and by their agreement to the same terms, there is an anomaly in holding one person bound to another of whom he knows nothing and with whom he did not, in fact, intend to contract. But middlemen, through whom contracts are made, are common and useful in business

transactions, and in the great mass of contracts it is a matter of indifference to either party whether there is an undisclosed principal or not. If he exists, it is, to say the least, extremely convenient that he should be able to sue and be sued as a principal, and he is only allowed to do so upon terms which exclude injustice.

The reasons upon which a real principal not disclosed can sue or be sued on a contract made on his behalf by an agent acting with his authority have no application to contracts made by one person for another, but without any authority from him. Some other reason must be found to permit a person to sue or be sued upon a contract not entered into by him through an agent or otherwise.

The principle relied on, and the only principle which by our law can be invoked with any chance of success, is that known as ratification, by which an approval of what has been done is sometimes treated as equivalent to a previous authority to do it. The mere statement of the general nature of what is meant by ratification shows that it rests on a fiction. Where a man acts with an authority conferred upon him, no fiction is introduced; but where a man acts without authority and an authority is imputed to him, a fiction is introduced, and care must be taken not to treat this fiction as fact.

It is not necessary to write a treatise on the doctrine of ratification in order to dispose of this case. Historically that doctrine is no doubt derived from the Roman law; but it has been extended and developed in this country conformably to our own legal principles and to meet our own commercial necessities; and it is to our own decisions rather than to the *Digest* and commentaries upon it that English courts must look for guidance. It is well known that in matters of contract we pay far less attention judicially to unexpressed intentions than is paid to them in other countries which have followed the Roman law more closely than we have. See *Byrne v. Van Tienhoven* (1880), 5 C. P. D. 344, 49 L. J. C. P. N. S. 316, 42 L. T. N. S. 371, 44 J. P. 667.

Roberts' evidence, on which the case turns, may be summed up by saying that it amounts to one or other of the two following statements, namely: (1) That he intended to buy, and did buy, as a principal, hoping and expecting that Keighley, Maxsted & Company would afterwards join him in his speculation; or (2) that he intended to buy, and did buy, on the joint account of himself and Keighley, Maxsted & Company as principals, hoping and expecting that they would, when informed of what he had done, ratify the transaction.

The first of these views of his evidence will not avail the plaintiffs; for in this view Roberts' contract, not having been made for Keighley, Maxsted & Company as possible principals, will not admit of ratification by them. The plaintiffs' counsel did not contend that it would, and they did not press the first view in argument.

The second view is not open to this objection, and ought to be left to a jury if there is any evidence that Roberts not only intended to buy, but did buy, on the joint account of himself and Keighley, Maxsted & Company. He swears that he did; so far as his intention is concerned, I will give him credit for what he says, but I am unable to discover any evidence of anything more.

Had Keighley, Maxsted & Company authorized Roberts to buy for them, there would have been a contract in fact, although Durant & Company did not know of them and did not intend to sell to them. This is, no doubt, an anomaly, as already pointed out; but there is a reality behind it. To apply the same sort of reasoning to a different state of facts from which the reality is absent is to go further than any existing authority, and to extend a fiction further than is required by those necessities or conveniences of trade which led to its introduction.

The doctrine of ratification as hitherto applied in this country to contracts has always, I believe, in fact given effect in substance to the real intentions of both contracting parties at the time of the contract, as shown by their language or conduct. It has never yet been extended to other cases. The decision appealed from extends it very materially, and I can find no warrant or necessity for the extension.

§367 *AMERICAN MINING AND SMELTING COMPANY v. JAMES W. CONVERSE & OTHERS.*

Supreme Judicial Court of Massachusetts, 1900.
[175 *Mass.* 449.]

CONTRACT, to recover a balance alleged to be due for money advanced by the plaintiff to the defendants. At the trial in the Superior Court, before FESSENDEN, J., the jury returned a verdict for the plaintiff; and the defendants alleged exceptions, which appear in the opinion.

HOLMES, C. J.: This was an action to recover a balance alleged to be due for cash advanced by the plaintiff to the defendants. The defendants were trustees under a deed of a mine, and lived in Boston. The money was advanced in Colo-

rado to one Armitage, the manager of the mine. The contest is on the authority of the manager to make the defendants liable, and the case is here on exceptions, especially to a refusal to direct a verdict for the defendants. On the testimony the case presented two aspects. One, it almost might be called the more obvious, was that the transactions were not loans in a proper sense, as they are treated by the defendants, but that they were executory purchases of ore in sight, with payments in the mutual account somewhat in advance of the amount of ore received at the moment, but in the expectation of speedy deliveries of ore enough to make the advances good. Ultimately deliveries were prevented by a heavy flow of water into the mine. As there was no doubt of Armitage's authority to sell, and as there was evidence that this mode of sale with advances was customary with mine managers in Colorado and was regarded as within the usual scope of their authority (see also *Robert E. Lee Silver Mining Co. v. Omaha & Grant Smelting Company,* 16 Col. 118), if this view of the case was taken by the jury, they reasonably might find for the plaintiff irrespective of any question of ratification on the ground that the money was advanced to the defendants upon an authorized contract of purchase which fell through, so that there was a failure of consideration and the defendants were bound to refund it. This was the substance of one part of the instructions excepted to, and it was correct. There is a plain distinction, although, as in many other instances, it may be difficult to draw in cases near the line, between transactions where the emphasized object is an advance of money, whether to be repaid in money or in goods, and those where the object is a sale, and where the advance, if it happens, is only incidental to the purchase, not its end. *Gilbert v. McGinnis,* 114 Ill. 28, 32, 33.

The other aspect of the case was that the money was borrowed by Armitage. There was evidence that it was borrowed, if it was borrowed, on the personal credit of the defendants. There was evidence also that all the facts, the nature of the arrangement, and the amount of money received, were reported by Armitage to the defendants, and that they replied, made no comments, and seemed satisfied that he was able to go on without drawing on them for more money. The argument for the defendants assumes on the strength of certain testimony that the transactions were, or at least properly were understood by the defendants to be, advances on the ore alone, without personal responsibility. But that was a question for the jury. To say the least, that was not the necessary conclusion from the evidence. The charge of the judge in putting the ques-

tion of ratification to the jury plainly was dealing with the evidence which showed an arrangement purporting to bind the defendants. The jury were warranted in finding such an arrangement, and that it was ratified. *Metcalf v. Williams*, 144 Mass. 452. *Harrod v. McDaniels*, 126 Mass. 413, 415. *Breed v. First National Bank of Central City*, 4 Col. 481, 507.

It is suggested that the judge erred in saying to the jury that there was direct evidence of a promise by the defendants to pay. But the judge was interrupted by counsel when he made this statement, and thereupon said that he would not undertake to state about the evidence. We think that the statement fairly was understood to be withdrawn, so far as it rested on particulars to which the judge then was referring. He went on to say that if the defendants had placed a person there clothed with apparent authority to do what he did, the defendants would be bound. This of course was true as an abstract proposition, and, as we have said, there was evidence that the managers of mines in Colorado, as such, were understood to have authority to make such contracts as Armitage made. Therefore the instruction was correct, notwithstanding the counter evidence that by Colorado law, managers of mines have no authority to borrow. It also was true, of course, as the judge said, that the fact that the trust deed provided that the defendants should be free from personal liability, *i.e.*, under the deed, did not limit their authority to contract personally with the plaintiff if they saw fit. There is nothing else in the bill of exceptions that requires special mention.

Exceptions overruled.

§368. *"Apparent Scope" in Tort Cases.*—The cases considered so far have been contract cases. In the following case, the question is raised as to the power to affect one's employer through liability for a tort. In this connection, the drawing of lines as to the scope of employment is much more difficult because it is impossible to resort to the terms of the employment which rarely include a commanding of the tort and business custom is equally silent on the subject.

§369 *MORIER v. ST. PAUL, MINNEAPOLIS, & MANITOBA RAILWAY COMPANY.*

Supreme Court of Minnesota, 1884. [31 *Minn.* 351.]

MITCHELL, J.: All the evidence in this case tends to prove that some section men, under the charge of a section

foreman, were, in the employment of defendant, engaged in repairing its railroad near defendant's farm, on the 21st of October, 1882. While engaged in such work, they usually returned to their boarding-house for dinner, but on this day, their work being at some distance, they took their dinner with them. At noon, when they quite work to eat, they built a fire, or rekindled one which some other person had kindled, on defendant's right of way, for the purpose of warming their coffee. After eating dinner they resumed their work, negligently leaving the fire unextinguished, which spread in the grass and ran on to plaintiff's land and burned his hay. There is no evidence that the defendant was boarding these men, or that it was any part of its duty to prepare or cook their meals. Neither is there anything tending to show that the defendant either knew or authorized the kindling of a fire for any such purpose, either on this or any other occasion. Nor is there any evidence that it was the duty of these section men to exercise any supervision over the right of way, or to extinguish fires that might be ignited on it. So far as the evidence goes, their employment was exclusively in repairing the railroad track.

The doctrine of the liability of the master for the wrongful acts of his servants is predicated upon the maxims, *respondeat superior* and *qui facit per alium facit per se.* In fact, it rests upon the doctrine of agency. Therefore, the universal test of the master's liability is whether there was authority, express or implied, for doing the act; that is, was it one done in the course and within the scope of the servant's employment? If it be done in the course of and within the scope of the employment, the master will be liable for the act, whether negligent, fraudulent, deceitful, or an act of positive malfeasance. Smith on *Master and Servant,* 151. But a master is not liable for every wrong which the servant may commit during the continuance of the employment. The liability can only occur when that which is done is within the real or apparent scope of the master's business. It does not arise when the servant steps outside of his employment to do an act for himself, not connected with his master's business. Beyond the scope of his employment the servant is as much a stranger to his master as any third person. The master is only responsible so long as the servant can be said to be doing the act, in the doing of which he is guilty of negligence, in the course of his employment. A master is not responsible for any act or omission of his servant which is not connected with the business in which he serves him, and does not happen in the course of his em-

ployment. And in determining whether a particular act is done in the course of the servant's employment, it is proper first to inquire whether the servant was *at the time* engaged in serving his master. If the act be done while the servant is at liberty from the service, and pursuing his own ends exclusively, the master is not responsible. If the servant was, at the time when the injury was inflicted, acting for himself, and as his own master, *pro tempore,* the master is not liable. If the servant step aside from his master's business, *for however short a time,* to do an act not connected with such business, the relation of master and servant is for the time suspended. Such, variously expressed, is the uniform doctrine laid down by all authorities. 2 Thompson on *Negligence,* 885, 886; Shearman & Redf. on *Negligence,* §§62, 63; Cooley on *Torts,* 533 *et seq.; Little Miami R. Co. v. Wetmore,* 20 Ohio St. 110; *Storey v. Ashton,* L. R. 4 Q. B. 476; *Mitchell v. Crassweller,* 13 Com. B. 237; *McClenaghan v. Brock,* 5 Rich. (Law) 17.

It would seem to follow, as an inevitable conclusion, from this, that on the facts of this case the act of these section men in building a fire to warm their own dinner was in no sense an act done in the course of and within the scope of their employment, or in the execution of defendant's business. For the time being they had stepped aside from that business, and in building this fire they were engaged exclusively in their own business, as much as they were when eating their dinner; and were for the time being their own masters, as much as when they ate their breakfast that morning, or went to bed the night before. The fact that they did it on defendant's right of way is wholly immaterial, in the absence of any evidence that defendant knew of or authorized the act. Had they gone upon the plaintiff's farm and built the fire, the case would have been precisely the same. It can no more be said that this act was done in the defendant's business, and within the scope of their employment, than would the act of one of these men in lighting his pipe, after eating his dinner, and carelessly throwing the burning match into the grass. See *Williams v. Jones,* 3 Hurl. & Co. 256. The fact that the section foreman assisted in or even directed the act does not alter the case. In doing so he was as much his own master, and doing his own business as were the section men. Had it appeared that it was a part of his duty to look after the premises generally, and extinguish fires that might be ignited on them, his omission to put out the fire might possibly, within the case of *Chapman v. N. Y. C. R. Co.,* 33 N. Y. 369, be considered the negligence of the defendant. But nothing of the kind appears, and the

burden is upon plaintiff to prove affirmatively every fact necessary to establish defendant's liability.

Order reversed, and new trial granted.

§370. *Note on Parental Liability for a Son's Use of the Family Automobile in* 28 *Harv. L. Rev.* 91.—"Generally the father is better able than the son to pay for harm caused by the latter. It is, however, well settled that at common law the parent is not liable for the torts of even his minor child.[1] But the injured party may benefit by discovering a master and servant relationship between the two.[2] Even this relationship avails nothing if the servant is acting for his own purposes 'on a frolic of his own.'[3] Thus when a hired chauffeur goes for a 'joy-ride' in his employer's car, the employer is not liable for any damage the chauffeur may cause.[4] This is so when he takes the car for his own delectation with or without permission.[5] Moreover, when a son takes his father's horse for his own affairs no liability attaches to the father.[6] Between a hired chauffeur and a pampered son there is a considerable difference in fact. The difference is still more marked between an automobile and a horse. Does the law make a distinction?

That the law does see a difference in the case of the son and the motor car combined, appears in a recent South Carolina case, where the son habitually drove the family machine with his father's consent. The father was held, although at the time of the accident the son was using the car for his own pleasure. *Davis v. Littlefield,*[7] 81 S. E. 487. The court ar-

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[1]*Chastin v. Johns*, 120 Ga. 977, 48 S. E. 343; *Moon v. Towers*, 8 C. B. (N. S.) 611.

[2]*Lashbrook v. Patten*, 1 Duv. (Ky.) 316; *Smith v. Jordan*, 211 Mass. 269, 97 N. E. 761.

[3]Parke, B., in *Joel v. Morison*, 6 C. & P. 501.

[4]*Lotz v. Hanlon*, 217 Pa. 339, 66 Atl. 525; *Jones v. Hoge*, 47 Wash. 663, 29 Pac. 433; *Hartnett v. Gryzmish*, 105 N. E. 988 (Mass.). But see *Whimster v. Holmes*, 164 S. W. 236 (Mo.).

[5]*Davies v. Anglo-American Auto Tire Co.* 145 N. Y. Supp. 341; *Cunningham v. Castle*, 127 N. Y. App. Div. 580.

[6]*Maddox v. Brown*, 71 Me. 432.

[7]The son was a minor, but this had no effect on the decision. For a statement of this case, and the two other recent cases cited in this note, see the issue of the Review at page 100.

gued that in giving himself health and pleasure the son was acting as his father's servant in the scope of his employment.[8] A few other cases have taken this view.[9] Where the son takes the family out, he might very properly be considered the servant of his father.[10] But when he frolics off with the automobile on a party of his own, this agency relationship is more difficult to conceive. Suppose, however, a frail son, or one injuring his health by too zealous an application to work. His affectionate, though wealthy father, is much concerned. He buys a machine and tells his son to use it in the pursuit of health and pleasure. While thus pursuing, the son pursues and runs down the plaintiff instead. If these facts could be proved, a not unwilling jury might find that the son's frolic was not a "frolic of his own," but really of his father's. The question is whether any father does this. It is submitted that most of them do not. Such an idea of vicarious enjoyment is far too fanciful—as much so in the case of an automobile as it would be, for instance if the father bought a pair of roller skates for the son, or told him to use the family roller skates. The argument might as well be extended to a chauffeur who is occasionally allowed the use of the car so that he will be more satisfied with his work.

Another line of reasoning has been applied recently in a Missouri case, where the father was held because an automobile is a dangerous instrumentality. *Hays v. Hogan,* 165 S. W. 1125.[11] The difficulty with this is that it is rather well settled

[8]The father had testified that he bought the machine for the "health and pleasure" of his family. Therefore, the court said, he made the health and pleasure of his family his business, and the son in enjoying himself was performing this business.

[9]See *Daily v. Maxwell,* 152 Mo. App. 415, 133 S. W. 351; *Birch v. Abercrombie,* 74 Wash. 486, 133 Pac. 1020. In *Kayser v. Van Nest,* 146 N. W. 1091 (Minn.), two sisters were out driving with friends. From the language of the court, the decision would have been the same had only one been present.

[10]*Smith v. Jordan, supra; McNeal v. McKain,* 33 Okl. 449 126 Pac. 742; *Missell v. Haynes,* 91 Atl. 322 (N. J.); *Ploetz v. Holt,* 144 N. W. 745 (Minn.).

[11]The Springfield Court of Appeals on an appeal from a motion granting the defendant a new trial gave judgment for the plaintiff. A motion for rehearing was overruled. but a motion to transfer to the Supreme Court was sustained on the ground that the case conflicted with previous decisions.

that an automobile is not a dangerous instrumentality.[12] As to boys the courts are silent.[13] An automobile is dangerous to third persons only when operated by a dangerous driver. So if the father entrusted the car to a very young or incompetent son, he might well be held on account of his own negligence—much as if he had given such a youth a gun.[14] But on the assumption that the son was *compos mentis* (except as afterwards shown by the 'joy-ride') the father should not be liable. A recent New York case has so held, following previous authority in that state.[15] *Heissenbuttel v. Meagher,* 162 N. Y. App. Div. 752. This is in accord with the majority of the decided cases.[16]

But it may be urged, on the other hand, that, as automobiles have latent possibilities of causing great damage, and yet are treated almost disrespectfully by the youngest children, as a matter of justice the owner should be absolutely liable for injuries inflicted. Such a rule might have a salutary effect, but its creation is within the province of the legislatures, not of the courts, and should not be arrived at by distorting the principles of agency and torts to fit the case.[17] Let not the ancient maxim be transformed to read, *Qui facit per auto facit per se.*''[18]

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[12]*Daily v. Maxwell supra; Cunningham v. Castle, supra; McNeal v. McKain, supra; Jones v. Hoge, supra; Parker v. Wilson,* 60 So. 150 (Ala.); *Danforth v. Fisher,* 75 N. H. 111; *Hartley v. Miller,* 165 Mich. 115, 130 N. W. 336; *Fielder v. Davison,* 139 Ga. 509, 77 S. E. 618. But see *Ingraham v. Stokamore,* 63 N. Y. Misc. 114; and *dicta* in *Doran v. Thomsen,* 76 N. J. L. 754.

[13]In *Allen v. Bland,* 168 S. W. 35 (Texas), the son, age eleven, owned the car. There was evidence to show that his head barely came above the steering wheel. The court said the automobile was not a dangerous agency. One might draw his own conclusions as to the boy.

[14]*Meers v. McDowell,* 110 Ky. 926, 62 S. W. 1013; *Johnson v. Glidden,* 11 S. D. 237, 76 N. W. 933.

[15]*Maher v. Benedict,* 123 N. Y. App. Div. 579. See also *Roberts v. Schanz,* 144 N. Y. Supp. 824.

[16]*Maher v. Benedict, supra; Parker v. Wilson, supra; Reynolds v. Buck,* 127 Ia. 601 103 N. W. 946; *Doran v. Thomsen, supra; Linville v. Nissen,* 77 S. E. 1096 (N. C.); 25 Harv. L. Rev. 734. *Tanzer v. Read,* 160 N. Y. App. Div. 584, was a case where the wife of the owner was driving. The court said she was in no sense acting as an agent.

[17]See remarks of Clarke, J., in *Cunningham v. Castle, supra.*

[18]Although to a Greek scholar such a maxim may appear sound, it is philologically incorrect, and should not be translated into English.

§371 *ARGERSINGER et al. v. MACNAUGHTON.*

Court of Appeals of New York, 1889. [114 *N. Y.* 535.]

BRADLEY, J.: This action was brought to recover damages alleged to have been sustained by breach of warranty in the sale by the defendant to the plaintiffs of a quantity of antelope skins, and the plaintiff recovered. The defendant was a commission merchant in the city of New York. The sale in question was in the line of his business, and made by him as such merchant. The referee found that the warranty was made by the defendant, that they were a sound, choice lot of Indian, handled skins, free from damage by worm-cut; and that there was a breach of such warranty. The evidence on the part of the plaintiff tends to prove those facts, and for the purpose of this review they must be deemed established. The main contention on the merits on the part of the defendant is, that he was not liable because the sale was made by him as agent of his consignors of the property sold. Upon that subject the referee found that the defendant did not sell the skins upon his own account, but as commission merchant, and that the plaintiffs knew that he was acting as an agent only, and that his commission was five per cent. The referee, however, determined that the warranty was the undertaking of the defendant, and that he was charged with liability by its breach.

. . . The defendant did not inform the plaintiffs, nor were they in any manner advised, of the name or names of the party or parties who sent the skins to the defendant to be sold by him. The question is presented whether the fact that the defendant failed to give the plaintiffs such information was sufficient to deny to him the right to make his agency effectual as a defense. It does not appear that the plaintiffs had any knowledge of the names of the consignors of the property, or that the defendant supposed they had such knowledge. In such case there is some reason to conclude that the defendant intended to make the warranty his own as between him and the purchasers. And the proposition that an agent contracting in his own name, and failing to disclose the name of his principal at the time of making a contract for the sale or purchase of goods, is personally liable for whatever obligation may arise out of the contract, has the support of authority. (*Mills v. Hunt,* 17 Wend. 333; *Morrison v. Currie,* 4 Duer, 79; *Cobb v. Knapp,* 71 N. Y. 348; *Ludwig v. Gillespie,* 105 id. 653; *Jemison v. Citizens' Sav. Bank,* 44 Hun. 412.) That doctrine is applicable to the present case. The defendant made the contract of sale in his own name, as commission merchant, with-

out disclosing the name of any principal; and his warranty given to produce it may, within that rule, as between the parties, be deemed his undertaking. In such case it may be supposed that a purchaser relies upon the responsibility of the person with whom he deals for the performance of the contract, and that he is not required to look elsewhere to obtain it. When there is, in fact, a principal, the agent may ordinarily relieve himself from personal liability, upon a contract made in his behalf, by disclosing his name at the time of making it. Upon such disclosure, however, the party proceeding to deal with the agent may or may not, as he pleases, enter into contract upon the responsibility of the named principal, but to permit an agent to turn over to his customer an undisclosed and, to the latter, unknown principal, might have the effect to deny to the customer the benefit of any available or responsible means of remedy or relief founded upon the contract. The rule is no less salutary than reasonable that an agent may be treated as the party to the contract made by him in his own name, unless he advises the other party to it of the name of the principal whom he assumes to represent in making it where that is unknown to such party.

This proposition is not inconsistent with the general rule that an agent, acting within the scope of his authority with a party advised of his agency, will not be personally charged unless it appears that such was his intention (*Hall v. Lauderdale,* 46 N. C. 70). The disclosure of his agency is not completely made unless it embraces the name of the principal; and without that the party dealing with him may understand that he intended to give his personal liability and responsibility in support of the contract and for its performance.

§372 *HAUPT v. VINT.*

Supreme Court of Appeals of West Virginia, 1911.
[68 *W. Va.,* 657.]

POFFENBARGER, Judge: . . . As J. J. DeRan, by whom the endorsement was made, has been made a defendant, it becomes necessary to determine, for the purpose of a new trial, whether his lack of authority to bind his principal makes him personally liable. Though it has been held that a person who has signed the name of another to a note or other contract without authority is liable thereon as promisor or covenantor, *Edings v. Brown,* 1 Rich. Law (S. C.) 255, *Dusenbury v. Ellis,* 3 Johns. Cas. 70; 2 Am. D. 144, reason and the weight of authority are to the contrary, and make him liable, not on the

instrument, as a party to it, but only as a warrantor of the signature, against whom *assumpsit,* sounding in damages, lies, or as a wrong doer, making him liable in trespass on the case for fraud and deceit. *Ballow v. Talbot,* 16 Mass. 461; *White v. Madison,* 26 N. Y. 117; *Dung v. Parker,* 52 N. Y. 499; Clark & Skyles, *Agency,* section 575: 1 A. & E. Enc. L. 1128; 31 Cyc. 1614-15, saying: "As to the ground upon which the liability of an agent contracting for another without authority rests, the authorities in the several states differ widely, nor is it easy to reconcile the various decisions in the same state. In some jurisdictions, particularly in the earlier cases, it is held that an action may be maintained against the agent as principal upon the contract itself, although it contains no apt words to bind him personally, but only to bind the principal, upon the theory that the contract must have been intended to bind some one, if not the principal, then the agent. By the great weight of recent authority, however, this theory has been emphatically repudiated, and it is now generally held, more logically, that the agent cannot be held upon the contract unless it contains apt words to bind him personally, in the absence of which the only remedy is by an action for the breach of his implied warranty or an action for deceit if the circumstances warrant the latter remedy."

Change of this common law rule by the statute, known as the Negotiable Instruments Law, chapter 81, Acts of 1907, has been suggested, Clark & Skyles, *Agency,* §575, Brannan, *N. I. L.,* p. 25, section 20; but, as the note was made in April, 1907, and the statute did not become effective until Jan. 1, 1908, it has no application. In view of the discussion we find in the text books and some decisions, concerning the question, we make the following observations by way of suggestion only, not as matter of decision: Express terms of liability are not found in section 20 of that act. The suggestion stands only upon the phrase, "if he was duly authorized." Hence, if the act imposes such liability, it does so by implication only. The section, read in the light of the general purpose of the statute, namely, uniformity of negotiable instrument law, and the conflict in decisions of the several jurisdictions, imports intent to accomplish other results. In other words, it deals primarily with a subject other than that of liability of a person professing to act as agent when he has no authority. It deals with the question of liability of an agent, having authority, but who has subscribed the name of his principal in a defective manner. To abolish the application of the theory of use of words as constituting only *descripto personae,* when an agent, having author-

ity, signs his own name, adding "agent for A. B." and the like, seems to be the real purpose of that section. Section 23 of the statute seems to deal with the question of personal liability on the part of the person signing as agent of another in such manner as to make such other person liable as principal, if the person professing to act for him had authority, but had not. It says, "Where a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative and no right to retain the instrument or to give a discharge therefor or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority." As we have seen, the authorities had been conflicting as to whether the agent could be held liable on the instrument, the weight of authority being in the negative. Was it not the plain purpose of the legislature to adopt the prevailing rule, subject to a limitation imposed by express or implied ratification, a subsequent guaranty or the like? The two sections must be read together, considered in the light of the general legislative purpose and harmonized. The implication suggested is not a necessary one. To adopt it would be the addition of something the legislature has not expressed simply because it may be supposed to be in the line of public policy, indicated by the statute. We must remember, however, that it is the province of the legislature not only to originate or adopt lines of policy, but also to prescribe means for their enforcement, and when it has prescribed certain measures for that purpose, there is a presumption that no others were intended. To add others, is, in my opinion, nothing short of judicial legislation.[1]

§373 *COCKRAN v. RICE.*

Supreme Court of South Dakota, 1910. [26 *S. D.* 393.]

[Plaintiff owned certain hay, and a granary containing wheat, all of the value of $912. Defendant was managing agent of the Western Land & Investment Company, which owned 40 acres adjoining the granary. Rice employed one Stevens to plow this field. Stevens sent his two boys to do the plowing, and they set

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[1]In accord with the dictum in the preceding case as to the effect of §20 of the Negotiable Instruments Law is an article in 10 Law Notes (American), 104. On the other hand, Dean Ames, Judge Brewster, and Mr. McKeehan seem to agree on the point that under this section an agent signing without authority is liable on the instrument. See Brannan's *Negotiable Instruments Law* (3rd ed.), p. 69. See §324, *supra.*

fire to stubble in the field. The fire spread and burned plaintiff's hay and granary. Plaintiff recovered judgment and defendant's appeals.]

SMITH, J.: . . . Appellant's contention that he cannot be held liable because he acted only as agent of the corporation cannot be sustained. His own evidence affirmatively shows that his agency was not disclosed to Stevens, nor is it shown that Stevens had any knowledge of the facts. Having assumed to act as principal, no reason is apparent why he should not be held to have assumed the responsibilities of a principal toward third persons for the act of a servant or employe. In 31 Cyc. 1555, the rule is very clearly and concisely stated: "An agent who enters into a contract in his own name without disclosing the identity of his principal renders himself personally liable, even though the third person knows that he is acting as agent, unless it affirmatively appears that it was the mutual intention of the parties to the contract that the agent should not be bound. With stronger reason, an agent who, without disclosing his agency, enters into contractual relations in his own name with one who is unaware of the agency, binds himself and becomes subject to all liabilities, express and implied, created by the contract and transaction, in like manner as if he were the real principal, although in contracting he may have intended to act solely for his principal. If the agent would avoid personal liability on a contract entered into by him in behalf of his principal, he must disclose not only the fact that he is acting in a representative capacity, but also the identity of his principal; although, if the other party has actual knowledge of the principal's identity, it would have the same effect to relieve the agent as a disclosure by the latter. The disclosure of the principal's identity need not be made at the inception of the transaction; it is sufficient if it is made before liability is incurred on either side; but a disclosure made after liability is incurred comes too late to relieve the agent from liability." 31 Cyc. 1560, says: "While an agent is not liable to third persons for injury resulting from his omission to perform a duty owed to the principal alone, he is liable to them for injury resulting from his misfeasance or malfeasance, meaning by those terms the breach of duty owed to third persons generally, independent of the particular duties imposed by his agency. Accordingly, an agent may be held liable in damages to third persons for conversion, fraud, and deceit, and even for negligence. In an action against an agent for misfeasance or malfeasance, it is no defense that he acted as agent or by the authority or direction of another, for no one can lawfully authorize the commission of a tort."

Appellant also contends that the evidence fails to show that the act of Stevens in starting the fire was done as a necessary part of the service rendered under his employment. This question was fully and fairly submitted to the jury under instructions decidedly favorable to the defendant, upon evidence disclosing all the surrounding conditions, and their verdict cannot be disturbed upon appeal.

A full and careful consideration of the entire record before us discloses no reversible error.

The order and judgment of the trial court are affirmed.

PRACTICE PROBLEMS

(a) The defendant's chauffeur was ordered to take home a certain infirm employee of the defendant. On arriving at the residence of the employee, the latter requested the chauffeur to take his wife's dressmaker to her home, which was in the direction of but far beyond the defendant's garage. While on his errand, but before reaching the defendant's garage, which he would naturally pass on the way, the chauffeur, while carelessly driving the automobile, injured the plaintiff, who was using due care. Has the plaintiff a good cause of action against the defendant? See *Clawson v. Pierce Arrow Motor Car Co.* (1918), 170 N. Y. Supp. 310.

(b) A freight agent of a railroad at a competitive point in order to accommodate a certain shipper, furnished him with several signed order bills of lading, upon the shipper's promise that he would properly fill out the blank spaces and that the goods to be described therein would be forthcoming. The shipper filled out the blank spaces in the bills of lading and delivered the instruments to a commission merchant who in good faith made advances upon the same. Later the commission merchant discovered that no goods were ever delivered to the railroad and he now seeks to hold the railroad responsible. Will he succeed?

(c) The proprietor of a local express business sold the business to the defendant company but remained in charge of the business as the agent of the buyer with authority to make settlements for all losses not exceeding $20. The plaintiff, who presented a claim for the loss of an expensive dress belonging to her, was authorized by the agent to "buy a new dress of the same kind and send the bill to us." The plaintiff acting under the impression that the agent was still the owner of the business, bought a new dress similar to the former one for $250. What are her rights? See *Brooks v. Shaw*, 197 Mass. 376.

(d) Action by contractor against owner for extra work performed upon the oral order of the architect. The contract contained the common stipulation: "If any extra work is required, a price for the same must be agreed upon and approved in writing by the architect

before such work is begun," but, as is also very common, the contractor did not secure a confirmation of the order "in writing." Is the contractor's claim legally valid?

(e) P gave to A, the general manager of his business, a power of attorney which authorized A to execute and indorse promissory notes in his name. A bought goods from T in P's name, and the goods were appropriate to P's business. However, A at the time intended to use the goods in his own household and they were actually so used. T was ignorant of the nature of P's business and of the use to which A meant to put the goods. T accepted in payment a note executed by A and signed "P." Is P liable upon the note?

(f) In the case of *Cockran v. Rice*, §373, could the corporation have been sued? Could the employees of the agent have been sued? Was the act complained of misfeasance, malfeasance or nonfeasance?

B. In Partnership.

§374 *DOWLING v. THE NATIONAL EXCHANGE BANK OF BOSTON.*

Supreme Court of the United States, 1892. [145 *U. S.* 512.]

HARLAN, J., Edward P. Ferry, of Grand Haven, Michigan, and George E. Dowling and Frank H. White, of Montague, in the same state, entered, February 1st, 1873, into written articles of co-partnership, "for the purpose of carrying on the business of sawing lumber, pickets, and laths at said village of Montague, in the steam saw mill lately there erected," the name of the firm being F. H. White & Co., and the partnership to continue for the full term of five years, unless sooner dissolved by agreement. Of the capital of the firm Ferry contributed one-half, and Dowling and White one-fourth each.

By the written terms of the partnership, no part of the capital was to be diverted or used by either partner, otherwise than in the business; the profits and losses were to be shared according to their respective interests; Ferry and Dowling were to have the care and charge of securing the sawing for the mill, the supervision of the financial part of the business and of the firm's books to be divided between them as they might agree, without charge for their services; and White was to have full management of the work of sawing, of hiring and discharging of men and fixing their wages, keeping double entry books, which should be open at any time for the inspection of the partners, and receiving for his services one thousand dollars, to be paid by the firm. It was further provided that the books of the firrm should be closed as of January 31st, in each year,

the profits then to be ascertained and passed to the credit of the respective partners, and applied in a specified way.

At the date of the several transactions out of which this litigation arose there was a firm, Ferry & Bro., at Grand Haven, Michigan, engaged in business as manufacturers of and dealers in lumber and shingles. It was composed of Thomas W. Ferry and Edward P. Ferry.

The present action involved the question of the liability of F. H. White & Co. upon three promissory notes, bearing date, respectively, Montague, Michigan, October 17th, 1882, November 27th, 1882, and January 15th, 1883, and for the respective sums of $5,288.75, $5,100.73, and $5,391.90, and payable, each, four months after date, to the order of Ferry & Bro., "at the National Exchange Bank, Boston, Mass., value received." Each note was indorsed by Thomas W. Ferry, in the name of Ferry & Bro., and was sold by him, acting in the name of his firm, to that bank. Neither White nor Dowling—whose firm continued in business under the above articles of partnership until May 31st, 1883—had any knowledge of the existence of these notes until after their respective maturities nor until shortly before the commencement of this action. Neither authorized the notes to be given. They were gotten up by Thomas W. Ferry, with the aid of Edward P. Ferry and one Thompson, the bookkeeper of Ferry & Bro., the latter acting under the direction of Thomas W. Ferry. The proceeds were used for the benefit of Thomas W. Ferry, or of his firm. The firm name of F. H. White & Co. to each note was signed by Edward P. Ferry, who did not communicate to White and Dowling that he had done so.

Separate actions having been brought by the bank upon the notes, they were, by consent, consolidated. Before the order of consolidation was made Dowling filed in each action his affidavit, stating that "on the 17th day of October, 1882, he was and still is a member of the co-partnership firm of F. H. White & Co., of Montague, Michigan; that firm was at said time, and still is, composed of Edward P. Ferry, Frank H. White, and this deponent as co-partners"; that "he never executed the promissory note, a copy of which was served upon him with the plaintiff's declaration"; that "the signature thereto is not in the handwriting of this deponent; and that said promissory note was not executed by any person having authority to bind this deponent or to bind the said defendants, Edward P. Ferry, Frank H. White, and this deponent jointly upon said promissory note."

A verdict was returned in favor of the plaintiff for $17,-791.45, the court saying to the jury: "Regretting very much

that these defendants White and Dowling, who alone make defense here, are in such a situation that they must suffer from the wrong-doing of their associate, the court is unable to relieve them without violating principles of law which are essential to the security of mercantile business, and violating also the rights of parties innocent of the wrong. As there is, in the opinion of the court, no question of fact about which there is any conflict in the evidence, the court holds that, giving effect to the testimony, the plaintiff is entitled to a verdict, and you are instructed to find accordingly against all the defendants.'' The opinion which preceded this charge is reported in 30 Fed. Rep. 412.

Judgment having been rendered upon the verdict, a severance was duly had between the defendants, so as to authorize a writ of error in the name of Dowling alone.

It is not disputed that the execution by Edward P. Ferry, in the name of F. H. White & Co., of the notes in suit, was without express authority of his partners, and that neither of the notes was given or used in the business of that firm. The primary question, therefore, is, whether, for the protection of the plaintiff, a *bona fide* purchaser for value, it will be conclusively implied, as matter of law, from the nature or course of the firm's business that Edward P. Ferry had authority from his partners to make those notes or either of them.

Mr. Justice Clifford, speaking for the court in *Kimbro v. Bullit,* 63 U. S. (22 How.) 256, 268, said that: ''wherever the business, according to the usual mode of conducting it, imports, in its nature, the necessity of buying and selling, the firm is then properly regarded as a trading partnership, and is invested with all the powers and subject to all the obligations incident to that relation,'' citing, among other cases, *Winship v. Bank of United States,* 30 U. S. (5 Pet.) 529, 561, Mr. Justice Story said that the doctrine that each partner may bind the firm by bills of exchange, promissory notes, and other negotiable instruments is generally limited to partnerships in trade and commerce, and does not apply to other partnerships unless it is the common custom or usage of such business to bind the firm by negotiable instruments, or it is necessary for the due transaction thereof. Story, *Partnership,* §102a.

In *Irwin v. Williar,* 110 U. S. 499, 505, Mr. Justice Matthews, speaking for the court, said: ''The liability of one partner, for acts and contracts done and made by his co-partners, without his actual knowledge or assent, is a question of agency. If the authority is denied by the actual agreement between the partners, with notice to the party who claims under it, there is no partnership obligation. If the contract of partner-

ship is silent, or the party with whom the dealing has taken place has no notice of its limitations, the authority for each transaction may be implied from the nature of the business according to the ordinary and usual course in which it is carried on by those engaged in it in the locality which is its seat, or as reasonably necessary or fit for its successful prosecution. If it cannot be found in that, it may still be inferred from the actual though exceptional course and conduct of the business of the partnership itself, as personally carried on with the knowledge, actual or presumed, of the partners sought to be charged." Again: "What the nature of that business in each case is, what is necessary and proper to its successful prosecution, what is involved in the usual and ordinary course of its management by those engaged in it, at the place and time where it is carried on are all questions of fact to be decided by the jury, from a consideration of all the circumstances which, singly or in combination, affect its character or determine its peculiarities, and from them all, giving to each its due weight, it is its province to ascertain and say whether the transaction in question is one which those dealing with the firm had reason to believe was authorized by all its members. The difficulty and duty of drawing the inference suitable to each case from all its circumstances cannot be avoided or supplied by affixing or ascribing to the business some general name, and deducing from that, as a matter of law, the right of the public and the duties of the partners."

It is very clear that the articles of agreement between Ferry, White and Dowling did not create a partnership, each member of which had, under the settled rules of commercial law, and as between the firm and those dealing with it, authority to give negotiable paper in its name. The firm was of the class denominated in many adjudged cases as non-trading or non-commercial firms, the members of which could not be held, as matter of law, and by reasons of the nature of the partnership business, to have authority to execute negotiable instruments in the name of the firm.

We quite agree with the learned judge who presided at the trial, that the liability of a partnership upon negotiable instruments executed by one partner in the name of the firm, exists not only where the firm is a trading or commercial partnership, but "where the actual course of business pursued adopts the practice of issuing the mercantile paper of the firm to accommodate its necessities or convenience whenever the occasions occur." But the difficulty in this case is that the jury were not permitted to determine, from a consideration of all the circum-

stances of the case, what, in view of the admitted nature of the business of F. H. White & Co., was necessary and proper to its successful operation, what was involved in the usual and ordinary course of its management by those engaged in it, or what should be inferred from the actual course and conduct of the partnership, so far as it was known, or ought reasonably to have been known, to the parties sought to be charged with liability on the notes in suit. We do not deem it necessary to make a detailed statement of the numerous facts disclosed by the evidence, or to suggest what inference might be drawn from them. It is sufficient to say that the issue as to whether the defendants were estopped to dispute the authority of Edward P. Ferry to make the notes in suit, in the name of F. H. White & Co., was one peculiarly for the jury, under all the facts indicating the nature, necessities and course of business of the firm, and under proper instructions from the court as to the legal principles by which they should be guided in determining the case.

We think the court erred in holding, as matter of law, that the jury were not at liberty, under any view of the facts, to find for the defendants. It seems to us that a verdict in their favor would not have been so palpably against the evidence as to have made it the duty of the court to set it aside and grant a new trial.

The judgment is reversed as to the defendant Dowling, who alone prosecutes this writ of error, with directions to grant him a new trial.[2]

§375. *From Sir F. Pollock. Digest of the law of Partnership* (9th ed.), pp. 31-33.—"The acts of a partner done in the name of a firm will not bind the firm merely because they are convenient, or prudent, or even necessary for the particular occasion. The question is, what is necessary for the usual conduct of the partnership business; that is, the limit of each partner's general authority; he is the general agent of the firm, but he is no more. 'A power to do what is usual does not include a power to do what is unusual, however urgent.'

Whether a particular act is 'done in carrying on a business in the way in which it is usually carried on' is a question to 'be determined by the nature of the business, and by the practice of persons engaged in it.' This must once have been a

[2]Cf. §22 *supra,* and §375, *infra.*

question of fact in all cases, as it still would be in a new case. But as to a certain number of frequent and important transactions, there are well understood usages extending to all trading partnerships, and now constantly recognized by the Court; these have become in effect rules of law, and it seems best to give them as such, and this we proceed to do. In other words, there are many kinds of business in which it is so notoriously needful or useful to issue negotiable instruments, borrow money, and so following, in the ordinary course of affairs, that the existence or validity of the usage is no longer a question of fact. But there is no authoritative list or definition of the kinds of business which are 'trades' in this sense. Thus it is hardly possible to frame a statement which shall be quite satisfactory in form.

It seems however that, subject to the limitations which will appear, every partner may bind the firm by any of the following acts:

a. He may sell any goods or personal chattels of the firm.

b. He may purchase on account of the firm any goods of any kind necessary for or usually employed in the business carried on by it.

c. He may receive payment of debts due to the firm, and give receipts or releases for them.

d. He may engage servants for the partnership business.

And it seems if the partnership is in trade, every partner may also bind the firm by any of the following acts:

e. He may accept, make, and issue bills and other negotiable instruments in the name of the firm.

f. He may borrow money on the credit of the firm.

g. He may for that purpose pledge any goods or personal chattels belonging to the firm.

h. He may for the like purpose make an equitable mortgage by deposit of deeds or otherwise of real estate or chattels real belonging to the firm.

. . . The distinction between the powers of partners in trading and non-trading firms is perhaps not quite clear on the authorities; . . . but it is believed that the existing practice

and understanding are correctly represented by the statement in the text.''

§376. *Uniform Partnership Act.* Section 9.—(Partner Agent of Partnership as to Partnership Business.)—(1) Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

(2) An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.

(3) Unless authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to:

(a) Assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership,

(b) Dispose of the good-will of the business,

(c) Do any other act, which would make it impossible to carry on the ordinary business of the partnership,

(d) Confess a judgment,

(e) Submit a partnership claim or liability to arbitration or reference.

(4) No act of a partner in contravention of a restriction on his authority shall bind the partnership to persons having knowledge of the restriction.''

§377. *From W. D. Lewis. The Uniform Partnership Act—A Reply to Mr. Crane's Criticism.* 29 *Harv. L. Rev.* 291.—''Section 9 (1) Provides that the act of every partner 'for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership. Mr. Crane suggests that instead of the words quoted the wording of the English Partnership Act should have been followed, which provides that 'Any act,' by a partner, 'for the carrying on in the usual way the business of the kind carried on by the firm,' binds the partnership.

The question raised by the suggestion, which was much dis-

cussed both by the Committee on Commercial Law and by the Commissioners, is: To what end should the inquiry of the court be directed when it has to decide the scope of a partner's apparent authority? Should the inquiry be: How did the partnership business appear to be carried on? or, How are businesses of the kind carried on by the partnership usually carried on?

It was argued in favor of the second view, as Mr. Crane has argued, that to declare that the inquiry should be: 'How is this partnership apparently carried on?' imposes an undue burden on the third person to learn the habits of this particular firm. On the other hand, it was contended that the wording of the English Act was susceptible of the interpretation that a partnership was bound, if the act was a usual act in the business of the kind carried on by the partnership, even though it was apparent that this particular partnership did not carry on the business in that manner. The argument which finally led the Commissioners to adopt the present wording was that it emphasizes the fundamental reason why a partnership is ever bound by an act of a partner not authorized by his co-partners, namely, that partners are bound because they have held him out to do that class of acts. The question therefore which should be determined in each case is, was it an act for apparently carrying on in the usual way the business of the partnership of which he is a member? Again, even if the contract was not one for carrying on in the usual way the business of the kind carried on by the firm, the partnership should be held, if it was a contract for apparently carrying on in the usual way that particular partnership; a matter which would be more than doubtful if the wording suggested by Mr. Crane had been adopted."

PRACTICE PROBLEMS

(a) A was conducting a business apparently as a sole trader but actually as a partner of B. A induced C to enter into a contract which was within the scope of the business of the firm, but which A had agreed with B in the partnership contract never to make without B's consent. At the time of the contract C did not know of the existence of the partnership. B's assent was never given to the contract. Is the contract binding on the partnership?

(b) A trading partnership doing business under the firm name and style of "A & Co." was composed of A, B, and C. A made two notes to the order of "A & Co." and indorsed one to his tailor for a suit of clothes ordered by him, and the other to a bank for cash. The cash was appropriated by A to personal uses. Is the firm liable on either of these notes?

C. In Corporations.

§378 *VICTOR v. LOUISE COTTON MILLS.*

Supreme Court of North Carolina, 1908. [148 *N. Car.,* 107.]

CONNOR, J., (after stating the facts): Eliminating all formal and irrelevant matter, we extract from the pleadings the following facts: The defendant cotton mills is, and was prior to 1 June, 1905, chartered and organized in the city of Charlotte, with a capital stock of $300,000, two-thirds of which is common and one-third preferred stock. Plaintiff is the owner of ten shares of common stock in said corporation. On and before said date the said corporation was, in accordance with its charter, operating a mill and machinery for the purpose of manufacturing cotton goods. On 30 June, 1905, the defendant Wilson was, and had for several years prior thereto been, the president of said corporation, and continued so to be until he resigned, on 2 October, 1906, since which time he has had no connection with said mills. Said Wilson was at the time of his connection with said mills "a manufacturer and financier of great capacity, skill and ability. The services which said Wilson performed for defendant mills during the whole time he occupied the position of its president were of great and peculiar value and of great benefit and advantage to the defendant and its stockholders, including the plaintiff, and such services as could be performed by the said Wilson only. On 30 June, 1905, the said J. P. Wilson, at the instance and request of the Louise Mills, made application for an insurance policy upon his life in the said Travelers Insurance Company for the sum of $100,000, for the benefit of the Louise Mills, under a plan of insurance known as "twenty-payment life." Two policies, No. 157589 and No. 157590, were issued in accordance with said application, for $50,000 each, and were made payable to the executors or administrators or assigns of J. P. Wilson, and the same were immediately after their delivery assigned by him to the Louise Mills, and said Louise Mills paid the first and all subsequent premiums thereon, and that the said policies are now in force, if the same are or ever were valid insurance contracts, and the next premium for the current year will be due thereon on 7 July, 1908.

The said Louise Mills has already paid upon said policies the sum of $13,926, consisting of the premiums due for the years 1905, 1906 and 1907, which were $2,321 a year on each policy. The plaintiff has made demand upon the said Louise Mills, its officers and directors that it and they cease and desist from any further payment of the funds of the corporation on account of said premiums.

The defendants, on the contrary, insist that the corporation had an insurable interest in the life of Mr. Wilson when the policy was obtained, and it being at that time and under the existing conditions a valid contract of insurance, it remains so, notwithstanding his resignation as president of the corporation.

The defendant Mills denies that the payment of the premiums from the funds of the corporation is an unwarranted diversion of such funds. The plaintiff's contention and application for injunctive relief are based upon two propositions:

1. That the amounts paid for premiums is an unauthorized and improper application or diversion of the funds of the corporation.

2. That the corporation has no insurable interest in the life of the defendant Wilson; that the policy is for that reason a gambling contract and therefore invalid; that upon the death of said Wilson its payment cannot be enforced in the courts of the state.

It is alleged and admitted that it is customary for corporations to insure the lives of their officers whose services are of peculiar value and whose death would impair the value of their stock. The extent of this custom is not alleged. In the view which we take of the question involved, it is not material. If the question of the personal liability of directors, in which the *bona fides* of their conduct was material, were involved, the general custom known to and acquiesced in by the stockholders would probably be material. We notice that the pleadings refer to the insurance and payments of premiums on the policy as the action of the corporation, and not of the board of directors. The complaint sets out the transaction as the act of the corporation, and the answer so admits it. The demurrer must be construed as admitting the allegation to be construed as most favorably to the defendants. We are, therefore, to deal with the question presented as calling into question the corporate act, and not involving any suggestion of an excess or abuse of power by the directors. There are, of course, many acts done by the board of directors which can be called into question only by the corporation in its capacity as a legal entity or by a stockholder conforming to the rule laid down in *Hawes v. Oakland*, 104

U. S. 450; *Merrimon v. Paving Co.,* 142 N. C., 539. If the act of the corporation be *ultra vires,* any one or more stockholders may by some appropriate method call it in question and, unless by having consented to or acquiesced in it he is barred, have relief. "As any stockholder may restrain the diversion of corporate funds for any purpose not embraced in the original purpose of the corporation, no majority, however large, can compel a stockholder to submit to any fundamental change in the business or objects of the company. A stockholder, by becoming such, contracts with the corporation that he will submit his interests to the direction and control of the proper officers of the company in carrying out the objects and purposes for which it was instituted; and the undertaking on the part of the company is that the objects and purposes of its institution shall not be changed without at least the unanimous consent of all the stockholders, and that no other responsibilities and hazards shall be imposed on the stockholders than those which grow out of the original undertaking. The right to restrain by injunction exists in a stockholder, though every other stockholder may favor the *ultra vires* acts." 2 Purdy's Beach on *Corp.,* §904. "And he may enjoin and set aside any acts which do not conform to these limits." 2 Cook on *Stockholders,* §681; *Pickering v. Stephenson,* 14 L. R. (1870), 340; *Wiswal v. Turnpike Co.,* 5 N. C., 183; Womack *Pr. Corp.,* 147. "It is no sufficient answer to the suit of a dissenting stockholder, in case of an *ultra vires* act, to say that no wrong or fraud was intended, or that it would benefit the corporation and be no injury to the stockholders. The fact is enough that it is *ultra vires.*" Purdy's Beach, §905. In *Central Railroad v. Collins,* 40 Ga. 582, it is said: "We do not think the profitableness of this contract to the stockholders of the corporation has anything to do with the matter. These stockholders have a right of their pleasure to stand on their contract. If the charters do not give these companies the right to go into this new enterprise, any one stockholder has the right to object. He is not to be forced into an enterprise not included in the charter. That it will be to his interest is no excuse; that is for him to judge."

"The right of a non-assenting stockholder to equitable relief does not depend in any respect upon the profitableness or unprofitableness of the transaction. He has the legal right that the corporation shall keep within the powers granted by the charter." *Byrne v. Elec. Mfg. Co.,* 65 Conn., 336, a very able opinion by Andrews, C. J., reviewing the authorities.

It is true, as held by numerous courts, including our own, that the doctrine of *ultra vires* has been very much modified in

recent years, and many contracts made in the course of business, especially when executed and benefits are received or liabilities are incurred, will be upheld and enforced which were formerly declared absolutely void. *Hutchins v. Bank,* 128 N. C. 72; Womack *Pr. Corp.,* 142. This modification of the doctrine does not involve the right of a dissenting stockholder or, in an appropriate case, the state to enjoin a threatened *ultra vires* act.

The plaintiff does not call into question the *bona fides* or the good judgment of the other stockholders. His principal apprehension appears to be that the corporation has no insurable interest in the life of Mr. Wilson, and that the assignment will be held void, or the policy itself so held. We are of the opinion that, conceding, for the sake of the argument, that a corporation has an insurable interest in the life of one of its officers within the ruling of a number of the courts, and conceding further that such interest continues after the relation is severed as in this case, these concessions by no means settle the question of the power of the corporation to take the assignment and pay, out of the corporate funds, the premiums on such policies. What the court may decide at the death of Mr. Wilson in respect to the right of the corporation to enforce payment, or, if paid by the insurance company, the right to hold as against his personal representative more of the proceeds than the premiums paid and interest, is uncertain. It is true that the company and Mr. Wilson are parties to this action, but it is by no means certain that these questions are "within the issues" arising upon these pleadings. The charter is not made a part of the pleadings, and there is no suggestion that it contains any express power to enter into this contract, or expand the assets of the corporation in payment of the premiums. In ascertaining the extent of corporate powers, the court will not, without an inspection of the charter, presume that unusual and extraordinary powers are conferred. It is elementary that the charter is the only source to which the court can look to ascertain what power is conferred. "A corporation . . . being the mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence." Marshall, Ch. J., in *Dartmouth College v. Woodward,* 4 Wheat. 518, 4 L. ed. 629. "An incidental power exists only for the purpose of enabling a corporation to carry out the powers expressly granted to it, that is to say, the powers necessary to accomplish the purpose of its existence, and can in no case avail to enlarge the express powers, and thereby warrant it to devote its efforts or capital to other purposes than such as its charter expressly authorizes, or to engage in collat-

eral enterprises, not directly, but only remotely, connected with its specific corporate purposes." 10 Cyc. Law & Proc. p. 1096. The complaint alleges that the plaintiff is a corporation, duly created, organized, and existing pursuant to the laws of this state, engaged in the operation of a cotton mill in the city of Charlotte. It is, therefore, a manufacturing corporation, with the powers usually conferred upon, and reasonably necessary to the accomplishment of the purposes of its creation, such as to erect the necessary houses for the installment of machinery, warehouses for storing its property, dwellings for its offices and operatives, buy raw or partially manufactured cotton, in such condition and quantities as the demands of its business require; to employ labor, buy fuel, and other things necessary or useful for its business; to sell the output of its mill; to borrow money and execute its notes; and to do all such other things as are reasonably incident to the accomplishment of its corporate operations. It may, of course, insure its property against loss or damage by fire or other accidents to which it is subject. It is not easy to enumerate the implied powers which attach to a corporation of this kind, and it would throw no light on the question involved in this appeal to attempt to do so. The learning and industry of counsel, and we have none at this bar who excel them, have failed to direct our attention to any case "in point." It is difficult to see where the power is to be found by implication. If the power to insure the lives of its presidents, or to have them insure their lives, and immediately, as a part and in furtherance of the arrangement with the presidents, transfer the policy, the corporation paying each premium, is to be found in the charter as incident to the express powers, we should find it difficult to fix any limit in respect to other officers or employees, or the amount of the insurance carried. If the power is found by implication in the charter of a cotton mill, why would it not be equally so in any and every business, manufacturing or moneyed corporation? . . . The power to insure the property against "loss or damage" by fire or tornadoes or other dangers usually the subject of insurance is based upon the power and duty of the directors to resort to the usual methods to protect and indemnify the company against such accidents. It is in accordance with the universal custom of prudent business management. We do not think that the insurance of the lives, certainly extending beyond the term of office or employment of its officers or employees, comes within the principle of implied or incidental powers. . . . The desire to eliminate the possibility of loss by the death of the president, during his term, is to be commended, but the necessity for

paying out large sums after his life has ceased to have any possible relation to the welfare of the company, with all of the uncertainty attendant upon the cost and ultimate result, requires an investment out of all proportion to the purpose in view in making the original contract. Without passing upon the question of insurable interest, which is not very clearly involved as the matters now stand, we conclude that the complaint and answer do not disclose any power, either express or implied, enabling the cotton mills to enter into or continue to pay out the assets of the company upon the contract. It is not one of the incidental powers vesting in a manufacturing corporation.

§379. *Corporation-Officer Insurance.*—The foregoing case refers to a custom of insuring the lives of officers of a corporation for the benefit of the corporation. From a business point of view, is the custom a wise one? What effect, for example, does it have on the credit of the corporation? Will the considerations in this case tend to check its growth? Compare the situation in partnership, where a well known type of "partnership insurance" has grown up to meet the situation.

For authorities on power of corporation to insure life of officer for benefit of corporation, see 16 L. R. A. (N.S.) 1020 and L. R. A. 1915 F, 979.

§380 *BELL v. KIRKLAND.*

Supreme Court of Minnesota, 1907. [102 *Minn.* 213.]

JAGGARD, J.: . . . 1. A proper preliminary consideration of the legal questions thus presented involves a brief reference to the attitude of the courts to the doctrine of *ultra vires*. That doctrine has been attacked with an earnestness amounting sometimes to asperity. "The doctrine of *ultra vires* is of very modern date and entirely the creation of the courts. There is no such thing as *ultra vires* in the case of a common-law corporation (case of *Sutton's Hospital,* 10 Coke, 30 C.), and it is not enacted in any statute. It affords, perhaps, the most remarkable instance in the history of English jurisprudence of the making of law by the judges; and, having once been created, it is now probably saddled onto the backs of the courts, like Sinbad's 'Old Man of the Sea,' not to be shaken off." 6 Cent. Law. Jour. 3. "The reasoning (on the subject) involves a strange confusion of ideas." 2 Morawetz, *Priv.*

Corp. Sec. 649. Judge Seymour D. Thompson regards the modern doctrine of *ultra vires* as a revolt against the ancient doctrine based on a species of moral reformation. His conclusion is "that the doctrine of *ultra vires* has no proper place in the law of private corporations, except in respect of contracts which are bad in themselves, the making of which is prohibited by considerations of public morality, of justice, or of a sound public policy, and which, therefore, stand upon such a footing that neither party can be regarded as innocent or blameless in entering into them." 28 Am. Law Rev. 398. And see 5 Thompson, *Corp.* §5969.

In 9 Harv. Law Rev. 255, Mr. George Wharton Pepper combats—and we think successfully—the existence of any clear distinction between the principles of the earlier and of the present decisions or of inextricable confusion on the subject in American reports. He recognizes, however, that, "in modern times there has been a steady movement in the direction of enforcing unauthorized and prohibited contracts between the parties." The tendency to what Mr. Cooke (28 Am. Law Rev. 227) calls "the extinction of the doctrine" is certainly very marked. 11 Harv. Law Rev. 387; 14 Harv. Law Rev. 332; 13 Am. Law Rev. 661.

§381 *HARRIS v. INDEPENDENCE GAS COMPANY.*

Supreme Court of Kansas, 1907. [76 *Kans.* 750.]

MASON, J.: Cornelius Carr and his wife executed to the Independence Gas Company an oil-and-gas lease; that is, an instrument granting the right to explore a tract of land for oil or gas and to appropriate either if found. The company is a Kansas corporation and at the time of the execution of the lease the only purpose mentioned in its charter was "to dig or mine for natural gas and sell the same for heat and lighting purposes." Later an amendment was made adding thereto the mining and selling of oil. What are called the "gas rights" under the lease have been transferred to another gas company and no point is raised with regard to them. The Carrs claiming that the lease so far as it related to oil was void because at the time it was executed the lessee had no authority to engage in the oil business, undertook to grant the oil privileges anew to C. C. Harris, who upon that ground brought a suit against the Independence company to cancel all of its contract excepting that portion relating to gas, joining his grantors as co-plaintiffs. The trial court sustained a demurrer to a petition setting

out substantially these facts and this proceeding is brought to review that ruling.

The defendant maintains: (1) That it had the implied power to produce and market oil as an incident to the express power granted to it to produce and market gas; (2) that if it originally lacked such power the defect was supplied by the charter amendment; and (3) that even if it had no authority to enter into the contract the plaintiffs cannot take advantage of the fact. It will only be necessary to consider the questions involved in the third proposition.

Although the decisions relating to the doctrine of *ultra vires* are characterized by some confusion as well as by much conflict, they admit of classification into fairly well-defined groups and exhibit a development in the direction of restricting the scope of its operation. Those courts which accord it the most favorable treatment—allow it the largest field of action—proceed upon the conception that a corporation, being the creature of the state, possesses no power whatever beyond that granted in its charter, and cannot directly or indirectly acquire rights or incur liabilities under any contract not thereby authorized. They refuse under any circumstances to enforce or give effect to an unauthorized contract, as such, but where it has been acted upon will protect the parties against hardship and injustice by allowing whatever relief may be suited to the facts of the case; for instance, by permitting either party to recover money or property which has been parted with in the transaction, or to have compensation therefor. The cases illustrating this treatment of the matter are collected in volume 29 of the A. and E. Encyc. of Law, at page 54, note 2. The theory is consistent and logical, but its practical effect is so to circumscribe the power of the court as to make the relief furnished at times inadequate to the occasion.

In a larger number of jurisdictions, although the same conception of corporate capacity is adopted, its effect is greatly changed by the application of another principle. Here the courts concede that a corporation has no power to make a contract except such as is conferred by its charter, expressly or by necessary implication. But they hold that as it must have some discretion in the manner of carrying out the purposes of its creation—some freedom of action—it is amenable to the same rules of conduct as a natural person, and may estop itself to question the validity of an agreement it has assumed to make, or may acquire the right to invoke a similar estoppel in its own behalf. Where this theory is accepted recovery may be had upon a contract which is in fact void, simply because its valid-

ity cannot be put in issue. The cases in point are gathered in volume 29 of the A. and E. Encyc. of Law, at page 57, note 1.

These cases have been criticized for the use they make of the word "estoppel" as descriptive of the principle upon which they are based. It is argued that as a corporation must know the terms of its own charter, and as one dealing with it is charged with like knowledge, neither party to an *ultra vires* contract can be misled in that respect, and therefore there must always be lacking an essential element of what could with technical accuracy be called estoppel. This, however, is a mere question of terminology. The requirement that one shall be consistent in conduct—shall not occupy contradictory positions—shall not retain the advantages of a transaction and reject its burdens—is often spoken of as a form of estoppel. The term is convenient, and, if inaccurate, is not misleading. This rule of estoppel affords a good working hypothesis to accomplish just results. If it fails to accomplish all that might be desired in a practical way it is because it is not made sufficiently far-reaching. It is generally held to be inapplicable to purely executory contracts, one reason stated being that "where neither party has acted upon the contract, the only injustice caused by a refusal to enforce it is the loss to the parties of prospective profits, and this is too slight a consideration to weigh against the reasons of public policy for declaring it void and not enforceable." (29 A. & E. Encyc. of L. 49.)

It might seem reasonable that a system which attempts not only to protect a party to an *ultra vires* contract from actual loss, but, where equity requires it, to insure to him the actual fruits of his bargain, ought for the sake of completeness and symmetry to enable him to insist upon the performance even of a purely executory contract. It certainly seems against conscience that one who has entered into a contract in the expectation of deriving a profit from it may upon discovering the probability of a loss repudiate it and escape responsibility by raising the question of want of corporate capacity.

. . . A large majority of the adjudications on the subject of *ultra vires* fall into one or the other of the two groups already referred to. The conception of corporate power upon which they depend has been styled that of "special capacities," in distinction from that of "general capacities." (See article by George Wharton Pepper on *Exercise of Corporate Power*, 9 Harv. L. Rev. 255.) The conception designated by the latter term is in brief that while a corporation has no right to exceed the limits of its charter it has the power to do so.

. . . The principle referred to, if sound, is manifestly

sufficient in itself to defeat the defense of *ultra vires* even when interposed against the enforcement of an executory contract; but it must be admitted that in practice it seems to have been applied only where the agreements had been at least partially performed. It seems often to have been invoked, however, in aid of the ordinary doctrine of estoppel, in cases where the contract upon one side or the other had already been performed.

. . . The principle referred to is closely allied to, if indeed it is not substantially identical with, that which forbids the regularity or validity of the organization of a corporation to be inquired into except at the instance of the state. (10 Cyc. 256.) The reason for such rule is thus stated in *Pape v. Capitol Bank,* 20 Kan. 440, 27 Am. Rep. 183:

"This is not upon the ground of equitable estoppel, but upon grounds of public policy. If the state, which alone can grant authority to incorporate, remains silent during an open and notorious assertion and exercise of corporate powers, an individual will not, unless there be some powerful equity on his side, be permitted to raise the inquiry. The law holds out no such encouragement to attempt to avoid the payment of contract debts." (Page 445.)

The question whether a corporation has a legal existence is a question whether it has capacity to act at all. This is essentially of the same character as the question whether it has capacity to enter into a particular contract—in other words, whether it has a legal existence for that purpose. The state grants the corporation the right to do business under limitations expressed in language to which both agree. Whether the language of the charter shall be interpreted to authorize a given act is a matter between the parties to it. If the state is satisfied with the construction upon which the corporation acts no reason is apparent why it should be open to question by a stranger, much less by one who has recognized it as valid by contracting with the corporation upon that basis. . . .

No Kansas statute declares that a contract made by a corporation in excess of its legitimate powers shall be void, or in terms permits the question of corporate capacity to be raised by one of the parties. Where it is held that no recovery can ever be had upon an *ultra vires* contract, as such, whatever relief is afforded is logically made to turn upon whether and how far the agreement has been acted upon. Where a recovery is sometimes permitted under the contract itself, upon the principle of estoppel, the question whether it has been carried out is likewise of manifest importance, there being a difference in degree at least between the attitude of one who has merely

entered into an engagement in expectation of obtaining an advantage from it and that of one who has actually reaped its benefits in whole or in part. But the doctrine that only the state can challenge the validity of acts done under color of a corporate charter, if accepted, must necessarily protect an executory contract from collateral attack equally with one that has been executed. The court is convinced of the soundness of the view that in the absence of special circumstances affecting the matter neither party to even an executory contract should be allowed to defeat its enforcement by the plea of *ultra vires*. The doctrine is logical in theory, simple in application, and just in result. It of course does not apply to contracts which are immoral or which are illegal, as distinguished from merely unauthorized, or to those made by public corporations. Nor does it forbid interference by a stockholder to protect his rights as such.

Upon these considerations the judgment is affirmed.

PRACTICE PROBLEMS

(a) By its charter defendant insurance company was authorized to engage in the business of "fire and life insurance." With the knowledge and acquiescence of all its stockholders, the officers of the corporation issued a policy of marine insurance to the plaintiff, who paid his premium and suffered a loss. What are plaintiff's rights?

(b) The officers of a hotel corporation in its name and with the knowledge of all its shareholders, embarked in the business of running a theatre. Accordingly, they contracted in the name of the corporation to engage an actress for a period of four weeks at a weekly salary. She performed for two weeks and received the salary for those weeks, but thereafter the officers refused further to employ her. The actress sues the corporation for breach of the contract and is met by the defense of "*ultra vires*." Judgment for whom?

(c) A corporation engaged in iron work manufacturing guaranteed the performance of a contract for the erection of a mining plant. It was induced to give this guaranty because the guaranty made it possible for the builder to secure the contract, thus enabling the company to make a sale of iron to the builder. In an action by the mining company for breach of this contract of guaranty, the iron work company sets up that the contract was *ultra vires*, and hence unenforceable against it. Judgment for whom?

(d) Corporation X, a manufacturing corporation, was in need of additional working capital. Among its assets were bonds of corporation Y which had been issued to X in payment for materials and supplies, and also bills receivable to the extent of $100,000 owed by corporation Z. X unconditionally guaranteed the payment of the princi-

pal and interest of the Y bonds and thereby induced A to buy them. In order to assist Z in procuring funds, X offered to guarantee the repayment of a loan of $200,000 to be made by B to Z. Accordingly, B made the loan of $200,000 to Z, and in accordance with a previous agreement, Z paid over $100,000 of this sum to X. Both Y and Z defaulted. What, if any, are the liabilities of X to A and B?

§382 *WAINWRIGHT v. P. H. AND F. M. ROOTS CO.*

Supreme Court of Indiana, 1912. [176 *Ind.* 682.]

COX, J.: Appellee is a private manufacturing corporation organized under the laws of this state, and carrying on its business in the city of Connersville. Appellant was formerly the superintendent of its factory, under supervision of its president; and while acting in this capacity, under a written contract of employment for a term of years which had not yet expired, and as a director of the corporation, be entered into another written contract, which cancelled the existing contract, and in which it was agreed, in substance, that appellee would separate from its factory a particular and considerable part of its manufacturing business, and install it in a special foundry and machine shop, to be properly constructed and equipped by appellee with the necessary machinery and appliances; that therein certain named articles were to be manufactured at a fixed schedule of prices; that, in addition to providing the building and machinery, appellee was to furnish all necessary capital to pay for labor and materials for manufacturing the articles to be turned out by the special factory; that appellant was to have entire control over the special factory, and was to provide all labor and materials necessary promptly and efficiently to perform the work contemplated, and was to turn such work out complete and first class in respect to workmanship, design and material at the prices fixed in the contract, or lower if possible; that the work was to be done under the cost system, and that if appellant succeeded in producing the work at less than the prices fixed in the schedule, the difference between the prices so fixed and the actual cost was to be divided equally between appellant and appellee; that in addition to such percentage of possible additional profits, appellant was to be compensated by a yearly salary of $1,800, and half the profit on repairs of articles manufactured and returned for repairs; that appellant was not to incur any liability in case of his inability to produce the various articles to be manufactured at the prices named;

and that the relation created by the contract should continue for five years.

This contract was entered into and executed by appellant and the president and general manager of appellee company. The performance of its provisions was never entered upon, and appellant sued for damages for its breach, alleging appellee refused to perform its part of the conditions and that he was ready at all times to perform those imposed upon him.

In addition to the general denial, appellee answered the complaint by second, third and fourth paragraphs of answer, to which appellant demurred. These demurrers were overruled, and these rulings are relied on by appellant as being reversible errors.

The second paragraph of answer was verified, and admitted the status of appellee as an Indiana manufacturing corporation, and the execution of the contract by Johnston, its president and general manager; but it averred, in substance, that the authority of such president was only that which the law gave the president of such a corporation, and that no additional powers had been delegated to him as president; that the only authority Johnston had as general manager of the company at the time of the execution of the contract was to manage its ordinary business affairs; that he was not authorized by the by-laws nor by the board of directors to engage in new enterprises, nor to delegate, by contract or otherwise, any part of the business of the company to the management and control of another; that Johnston, neither as president nor as general manager, had authority to execute the contract in the name of and for and in behalf of the company, and that neither the directors nor the stockholders had ever ratified or approved the action of Johnston in executing it.

The statute authorizing the creation of corporations such as appellee, provides that the business of such corporations shall be managed by the board of directors, for the election of which the statute makes provision. §5070 Burns 1908, §3854 R. S. 1881.

The second paragraph of answer alleges that, as president, Johnston had only such powers as the law gave him.

The section of the statute placed the power to manage the business of appellee in its board of directors, and no such power is conferred on the president as such.

The general rule is that the office of president of a private corporation of itself confers no power on the incumbent to bind the corporation or control its property. His powers as agent must come by delegation from the corporation through the board

of directors, formally and directly granted, or implied from its habit or custom of doing business. 10 Cyc. 903; 3 Cook, *Corporations* (6th ed.) §716; 2 Thompson, *Corporations* (2d ed.) §§1451, 1464; *National State Bank v. Vigo County Nat. Bank* (1895), 141 Ind. 352, 355, 50 Am. St. 330. The answer alleges that no authority beyond that given him by law had been delegated to Johnston as president.

The office of general manager is of broader import than that of president, and implies authority in one invested with it to do such acts as are necessary in the usual and ordinary course of the business carried on by the corporation. 10 Cyc. 909; 3 Cook, *Corporations* (6th ed.) §719; 2 Thompson, *Corporations* (2d ed.) §§1465, 1466, 1575; 4 Words and Phrases p. 3073 *et seq.; Louisville, etc., R. Co. v. McVay,* (1884), 98 Ind. 391; *Cushman v. Cloverland Coal, etc., Co.* (1907), 170 Ind. 402, 405.

But here we have a contract of rather an unusual and extraordinary character. The general manager gets his authority by delegation from the board of directors. Under our statute the directors are elected annually by the stockholders. The stockholders then may make an entirely different board of directors in one year and such new board may displace the general manager and select another. The terms and character of the contract under consideration may not only give rise to the implication that it may be beyond the usual and ordinary course of the business of appellee in separating that part dealt with from the main business, and placing it under the entire control of appellant, with a division of the profits, but it also does this for a period of five years which may be beyond the terms of both the general manager and board of directors. Added to this showing, the answer directly alleges that Johnston as general manager had no authority to execute the contract for the corporation, and that it was never ratified nor approved by the board of directors or stockholders. The answer by force of this last allegation was sufficient to withstand a demurrer, and raised an issue of fact whether Johnston had such authority.

As regards the powers legally incident to the office of president of a corporation the authorities are rather evenly divided. "Many authorities which are constantly increasing in number, hold that he has presumptively by virtue of his position a general right of superintendence over the company's affairs in the interim between meetings of the board of directors, and that his powers are presumptively those of a general manager of the business." (Machen, *Modern Law of Corporations,* §1668.)

CHAPTER XIII

INTERNAL RELATIONS AND CONTROL.

A. IN AGENCY.

§383 *ESSEX TRUST COMPANY v. ENWRIGHT.*

Supreme Judicial Court of Massachusetts, 1913. [214 *Mass.* 507.]

LORING, J.: The question on which the decision in this case depends is this: In case a reporter on a newspaper in the course or by reason of his employment learns that the premises on which the business of publishing the paper is conducted are of peculiar value to his employer or one carrying on his business, has he the right without his employer's knowledge to take a lease of the premises and hold them as his own to the injury of his employer's property?

It is not found directly as a fact, but it is the fair inference to be drawn from the facts found, that the defendant learned in the course or by reason of his employment of the peculiar value which these premises had for his employer. It was found directly (in effect) that knowledge of the fact that his employer was in arrears in the payment of rent came to the defendant by reason of his employment. That fact, however, is a fact of secondary importance.

The doctrine invoked by the plaintiff in this suit had its origin in two decisions by Lord Eldon. In *Yovatt v. Winyard,* 1 Jac. & W. 394, the defendant (formerly employed as a clerk by the plaintiff, who was a veterinary surgeon) was enjoined from using medicines compounded from the plaintiff's recipes which he (the defendant) had surreptitiously copied while in the plaintiff's employ. . . .

Since then the doctrine has been applied in England in a number of cases. In *Morison v. Moat,* 9 Hare, 241, the defendant was enjoined from using a secret formula for compounding a medicine which had been disclosed to him, in violation of a contract made with the originator of the formula. In *Tuck & Sons v. Priester,* 19 Q. B. D. 629, the defendant, who had been

employed by the plaintiff to print two thousand copies of a picture belonging to him, was enjoined from selling further copies of it which he had taken surreptitiously. In *Pollard v. Photographic Co.,* 40 Ch. D. 345, a similar decision was made; in that case the defendant printed for his own use further likenesses of the plaintiff from a negative which he had made when photographing the plaintiff in the ordinary course of his business as a photographer.

In *Helmore v. Smith,* 35 Ch. D. 449, a clerk was committed for contempt on its being shown that he had taken a copy of the customers of a business conducted by a receiver appointed by the court and that he had solicited their custom for a competing business which he had set up for himself. A similar decision as to the use of a list of the plaintiff's customers surrepitiously copied by a clerk was made in *Robb v. Green* [1895], 2 Q. B. 1. In *Merryweather v. Moore* (1892), 2 Ch. 518, a clerk was enjoined from communicating to a subsequent employer the details of machinery manufactured by his former employer, the plaintiff; and in *Lamb v. Evans* (1893), 1 Ch. 218, the defendants, who had been employed to secure advertisements for the plaintiff's Trades Directory and who by the terms of their employment furnished at their own expense the blocks and materials necessary for producing the advertisements, were enjoined from using the blocks and materials so obtained in aid of a competing directory. For two other cases where the doctrine was applied see *Tipping v. Clarke,* 2 Hare, 383, 393, and *Kirchner v. Gruban* (1909), 1 Ch. 413, 422. In the latest of these cases (*Kirchner v. Gruban* (1909), 1 Ch. 413, 422), Eve, J., states the doctrine of these cases in these words: "I think it is abundantly clear upon the authority of *Robb v. Green* (1895), 2 Q. B. 315, that the real principle upon which the employee is restrained from making use of confidential information which he has gained in the employment of some other person is that there is in the contract of service subsisting between the employer and employee an implied contract on the part of the employee that he will not, after the service is determined, use information which he has gained while the service has been subsisting to the detriment of his former employer." . . . The doctrine was recognized by this court in *Chadwick v. Covell,* 151 Mass. 190, and *Covell v. Chadwick,* 153 Mass. 263, which had to do with formulas for compounding medicines, and in the recent case of *American Stay Co. v. Delaney,* 211 Mass. 229.

There are two cases, one in California and the other in Illinois, which have gone as far in the application of this doctrine

as we are asked to go in the case at bar. In *Gower v. Andrew,* 59 Cal. 119, the defendant, a clerk employed by the plaintiffs, who were warehousemen, secured a lease of the warehouse in which the business was conducted, behind his employers' backs, by telling the owner of it that the "plaintiffs would probably give up the warehouse," and offering an advance of $50 a month in the rent. The defendant then began soliciting custom for himself as the successor of his employers. On this becoming known he was discharged by his employers and was ordered by the court to assign the lease to the plaintiffs. In *Davis v. Hamlin,* 108 Ill. 39, Davis, who was the defendant in the court below, was hired by Hamlin, the lessee of one of four important theatres in Chicago, as his business manager. A year and three months before Hamlin's lease expired Davis behind Hamlin's back secured for himself a lease (to begin on the expiration of Hamlin's lease) by giving $4,500 more rent a year. It appeared in evidence that Hamlin had built up a good will in connection with his theatre by ten years' occupancy. Davis was directed to hold the lease which he had secured as trustee for Hamlin.

The defendant has argued that he was not within this rule because the duty of securing a lease was not entrusted by his employer to him. The same contention was the main argument put forward in *Davis v. Hamlin,* and was true of the clerk in *Gower v. Andrew.* The complaint against the defendant is that he has made use of information which has come to him in his employment to the detriment of his employer. In our opinion that is enough to entitle the employer to equitable relief.

§384. *Business Ethics in Relation to Agency.*—The case illustrates the absolute loyalty and fidelity required of agents. The same is true of partners in their dealings *inter se* and of officers of a corporation, with respect to the corporation:

If such "agents" make a profit through misuse of the principal's business or funds, they are answerable for the profit as well as the principal sum. If they suffer losses through the misuse of funds, they must bear the losses themselves.

As regards secret commissions received by the agent, the legal rule has been expressed to be: "The principal is entitled to the agent's graft." Professor Dicey (*Law and Opinion in England* at p. 366) has remarked: "Even at the present day the Courts maintain, or attempt to maintain, rules as to the

duty of an agent towards his employer which are admitted by every conscientious man to be morally sound, but which are violated every day by tradesmen, merchants, and professional men, who make no scruple at giving or accepting secret commissions; and these rules Parliament hesitates or refuses to enforce by statute. Here, at any rate, the morality of the Courts is higher than the morality of traders or of politicians."

The high degree of loyalty which the law requires of an agent may, under some conditions, lead the law to take cognizance of the "ethics" of a man's position. The agent or employee may be interested in considering such questions as the following with respect to both their legal and ethical aspects:

1. Are any portions of your work of a confidential nature?

2. Is any of the information acquired by you in the course of your employment of such a nature, that you would not feel free to use it in any position you may take hereafter? How is this determined?

3. If you are free to engage in any other remunerative employment during spare time while holding your present position, what are the limits as to competition with your employer? What are the limits as to the amount of attention and energy that you may devote to such outside work?

4. Does your position permit you to direct your attention to personal affairs during the day? What are the rules or general understanding of your place as to telephone calls for employees during the day?

5. At the expiration of the time for which you are bound by contract, would it be considered unethical (that is "condemned by the business world") for you to take another position without previous notice to your present employer? Would it make any difference in the eye of the business world if he was in the middle of a rush season or rush order—if you received your training at your present place of employment—if you had been in your present position a very long time—if the opportunity offered you in the new position was an exceptionally good one?

6. If you travel for your house, or are otherwise permitted to run up expense accounts, on what basis is it

determined what accommodations are proper, how much is to be allowed for meals, etc.?

7. Is it proper under the present circumstances of your position to use house stationery, stenographer, etc., for your personal correspondence?

8. In buying for your house, is it proper to give your personal friends the preference, or to pay off personal scores with house patronage, assuming, of course, that prices and qualities are the same?

PRACTICE PROBLEMS

(a) Plaintiff was employed by the defendant, as agent, to sell two lots of land. Lot number one was to be sold at a certain minimum price; lot number two was also to be sold at a certain minimum price, it being, however, further agreed with respect to this lot that the agent was to have as commission all that he could obtain above that price. Plaintiff now wishes to buy both of these lots for himself at the stated minimum prices. State the rules of law applicable to the situation.

(b) S employed A to sell his estate for $20,000. A had previously been authorized by B to buy the estate of S for $20,000, but this fact was unknown to S. After informing B that S had authorized him to act as agent to sell the estate for $20,000, A negotiated a contract between S and B for the sale of the land for $20,000. Is A entitled to a broker's commission from either or both S and B?

§385 *RANDALL v. PEERLESS MOTOR CAR CO.*

Supreme Judicial Court of Massachusetts, 1912. [212 *Mass.* 352.]

RUGG, C. J.: . . . But the further instruction was given that the mere making of the agreement by the plaintiff on January 17 to act as agent for the Stevens-Duryea car (if found to be a competing car) would not be such a violation of his contract as to warrant rescission by the defendant on January 21 unless he did something in the meantime to interfere with the devotion of his best energies to the interests of the defendant. To determine the correctness of this ruling involves some analysis of the contract. It was in one respect merely a contract for purchase and sale of automobiles. As has been pointed out in discussing the "best energies" clause, the plaintiff was not strictly an employee of the defendant, but an independent dealer. In other respects, it created the relation of principal and agent. The words "agent" and "agency" occur several times in the contract. In a broad sense these words were used accurately in view of what both parties contemplated. The plaintiff had no right to undertake any obliga-

tion inconsistent with his duty to the defendant vigorously and intelligently to push the sale of the defendant's product in New England. All sales of those products were to be made by the terms of the contract exclusively by the plaintiff in the territory described. There is no inconsistency in the establishment of this double relation of an agreement for sales and for agency. They may co-exist and impose binding duties if this is the intention of the parties. That is what this contract did in express terms. In this regard the case is similar to *John Hetherington & Sons v. William Firth Co.,* 210 Mass. 8, 22, 25. It is firmly established that the agent is bound to exercise at all times the utmost good faith toward his principal. This is not a "technical or arbitrary rule. It is a rule founded upon the highest and truest principles of morality." *Parker v. McKenna,* L. R. 10 Ch. 96, 118. Agents are not permitted to put themselves in a position antagonistic to the interests of those whom they represent. They cannot serve two masters. It is not a question whether in fact the principal has suffered actual injury. The policy of the law is contravened by the creation of the temptation for wrongdoing by entering into the adverse relation, and it is not necessary to go to the extent of showing that the opportunity was embraced. The mere act of signing a contract of agency which created legal obligations inconsistent with those assumed under the pre-existing contract with the defendant was an act which by itself alone justified the termination of the contract by the defendant. *Little v. Phipps,* 208 Mass. 331, 333. *Quinn v. Burton,* 195 Mass. 277. *Erskine, Oxenford & Co. v. Sachs* [1901], 2 K. B. 504. *Cotton v. Rand,* 93 Texas, 7, 23. Nor was it necessary that the defendant should have known of the making of the antagonistic contract with the competing company when it is said to have terminated the contract involved in this action on January 21. Nevertheless, it may serve as a sound ground for termination of the contract, if it be found to have existed. The defendant no longer was bound to continue an agency agreement with one so unmindful of his duty in that regard as to enter into an adversary contract, even though he had not commenced its performance. *Boston Deep Sea Fishing & Ice Co. v. Ansell,* 39 Ch. D. 339, 357. The defendant excepted to this paragraph of the charge expressly. It was erroneous in law. As it is conceivable that the jury may have believed the evidence to the effect that the Stevens-Duryea car was a competitor of the Peerless in 1903, it cannot be said that this erroneous instruction was not prejudicial to the defendant. It may have been decisive in causing the jury to reach the general finding in favor of the plaintiff.

§386 *WALKER v. JOHN HANCOCK MUTUAL LIFE INS. CO.*

New Jersey Court of Errors and Appeals, 1910. [80 *N. J. L.* 342.]

SWAYZE, J., delivered the opinion of the Court:

The plaintiff was employed by the defendant in 1885 as an agent to solicit policies of life insurance. His own account of the contract, which was an oral one, is that he agreed to go to work for the company upon the condition that he was allowed to retain his "debit" as long as he could collect it, and as long as he was healthy and able to work. The debit was the amount of premiums on policies which the plaintiff was entitled to collect. His compensation was to be 20 per cent. on collections, and nine times the first premium for writing the policies. Since the plaintiff was non-suited, we must accept his statement of the contract as true. He continued to work under the contract for nineteen years, and wrote many policies, so that his debit increased to a considerable sum per week, on which he was entitled to 20 per cent. on collection of the premiums. In 1904 the defendant undertook to make an inspection of his work. This consisted in the inspector going with the plaintiff on his rounds to collect premiums, and checking up the books that the policy holders held, in which their receipts were entered, with the accounts rendered by the plaintiff. The plaintiff now claims that he was informed that the only object was to ascertain the addresses of the policy holders, but he admits that he knew from his own experience that in fact an inspection was in progress. The inspection continued for about two weeks without objection on plaintiff's part, and was about nine-tenths completed when a controversy arose. The inspector insisted on going over some of the ground again, and the plaintiff refused to permit it, and was thereupon discharged. He admitted in his testimony that to make an ideal inspection it was necessary to do as the inspector wished. At the trial the defendant alleged, as an additional justification for the discharge, the fact that the plaintiff had received premiums by mail from policy holders, contrary to a rule of the company adopted after the contract between the plaintiff and defendant had been entered upon. The fact is conceded, and the claim of the plaintiff is that the defendant had no right to adopt such a rule, since it altered the contract.

It is elementary that a principal has the power to revoke his agent's authority at any time, except where it is expressly made irrevocable, or where it is coupled with an interest or given for a valuable consideration or as part of a security. A

distinction must be made, however, between the principal's power to terminate the authority of the agent to act for him and bind him to third persons, and the right of the principal to terminate the relation without liability to the agent. As between the principal and the agent, the right depends on the terms of the contract, and, if the agent is discharged in violation of those terms, he has a right of action for the wrongful discharge. In this respect the contract and the rights thereunder are analogous to the ordinary contract between master and servant. In every contract of service, certain terms are implied. Illustration of terms implied in a contract of agency are to be found in the notes in 31 Cyc. Law & Proc. pp. 1301, 1302. In every contract of service, it is implied that the employee shall obey the lawful orders of the master, at least so far as they are reasonable, and not merely arbitrary or capricious. *Larkin v. Hecksher,* 51 N. J. L. 133, 3 L. R. A. 137, 16 Atl. 703. In *Lehigh Valley R. Co. v. Snyder,* 56 N. J. L. 326, 28 Atl. 376, the obligation to obey reasonable regulations was an express term of the contract. The question usually arises in cases between master and servant, because the nature of that relation more frequently gives occasion for specific commands of the master; but the obligation of the agent to pursue his authority is essentially of the same character, and is coupled with the duty to obey instructions. Evans, *Principal and Agent,* §253. Another well-recognized duty of an agent is the duty to account for money of his principal received by him. This involves the right of the principal to assure himself that the accounts are proper and correct. Measures taken in good faith by the principal, to secure a proper accounting and to assure himself of its propriety, are therefore not in violation of the contract, although they may not be within its express terms. We see no reason to doubt that what the defendant required in this case was required in good faith, and was reasonably necessary to the proper conduct of its business. The amount of the plaintiff's debit for which he was accountable was $261. This represented the total of premiums on some 2,500 policies, which it required two weeks to collect. The plaintiff admits that, to make an ideal inspection, it would be necessary to do just what the defendant's inspector asked to do. The plaintiff did not object to an inspection, for he permitted it without objection for two weeks. He drew the line, however, at an ideal inspection. We think it was for the company to determine how thorough an inspection it should make. It was entitled, in behalf of its policy holders, to be thoroughly satisfied of the correctness of the plaintiff's accounts. When the plaintiff refused

to permit a thorough or ideal inspection, the defendant was justified in discharging him.

He concedes, also, that he violated the rule of the company forbidding him to collect premiums by mail. We think the method of collection also was a matter to be determined by the company in the exercise of its right to control the conduct of its own business. Since this rule was adopted after he entered the company's employ, he was entitled to notice of it, but that he had. His violation of this rule also justified his discharge.

The fact that his discharge was justified does not, however, determine his right to maintain this suit. That depends upon the proper construction of the contract. *Wilcox & G. Sewing Mach. Co. v. Ewing*, 141 U. S. 627, 35 L. Ed. 882, 12 Sup. Ct. Rep. 94. If his right to receive 20 per cent. on the collections was a part of his compensation for securing the business and writing the policy, the company, could not deprive him of that compensation which he had already earned, by preventing him from collecting the future premiums. Since, upon this writ of error, there can be no dispute about the terms of the contract, the construction is for the court. He says he was to get 20 per cent. on collections, and nine times the first premium for writing it. A natural construction is that the payment for securing the business—"for writing it"—was to be nine times the first premium, and that the 20 per cent. was for services in collecting future premiums. In view of the small size of the premiums, this is not unreasonable. For a policy on which the premium was 10 cents, he would receive 90 cents for writing it, and 2 cents for the collection of each premium after the first. We find nothing in the contract to lead us to believe that the 20 per cent. commission was a part of the compensation for writing the policy. The plaintiff did not, in fact, collect the premiums that became due after his discharge, and the only remaining question is whether he is entitled to damages because he was deprived of the chance to earn his commission. Since that was pay for future services, the plaintiff's right depends on whether his discharge was rightful or wrongful. The authorities so hold. . . .

The great weight of authority is against the right of the agent to commissions on renewal premiums paid after he has been rightly discharged. The cases where there was an express right to terminate the agency are in point, since such an express right can be no stronger than the legal right arising out of the legal relations of the parties implied by the law. The result is in accordance with sound principles, since, if the discharge is

rightful, it must arise out of the agent's fault, and he ought not to retain the benefit of a contract which he has himself broken.

We think the learned trial judge rightly ordered a non-suit, and the judgment is affirmed, with costs.

§387 *BANK OF OWENSBORO v. WESTERN BANK*

Court of Appeals of Kentucky, 1877. [13 *Bush* 526.]

JUDGE COFFER delivered the opinion of the Court:

The appellant and appellee are both incorporated state banks, doing a general banking business, the former in Owensboro, and the latter in Louisville.

July 17, 1872, the appellant had money on deposit with the appellee, and, on that day, by its cashier, W. K. Anderson, wrote to Henry Hurter, appellee's cashier, as follows: "We would like to have you invest some means for us, if you can, in good paper at thirty, sixty, ninety or one hundred and twenty days' time."

July 24, 1872, Hurter, in a letter signed "Henry Hurter, cashier," wrote to appellant's cashier that he had, on that day, loaned for appellant, to Robert Atwood, $5,000 on his note at ninety days, secured by seventy shares of Bank of Louisville stock, certificates for which, indorsed by Atwood, he then held, and would forward to appellant if desired. In the afternoon of the same day Hurter wrote a second letter in which he said, "I omitted to inquire in my letter of this morning whether you wish the collaterals transferred on the books of the Bank of Louisville to your name and certificates issued." In reply to the first of these letters appellant wrote, acknowledging the receipt of Atwood's note, and returning it for collection, and also that the investment was entirely satisfactory; and in reply to the second, "We do not care to handle at all the collaterals on any paper you may discount for us. Do by them as you would if yours."

About August 15 Atwood failed, and Hurter wrote to the appellant as follows: "At the time I loaned Mr. Atwood $5,000 of your funds on Bank of Louisville stock as collateral security, I went to the Bank of Louisville and ascertained from Mr. Morgan, the cashier, that the bank held no lien upon that stock, and informed Morgan, as there was no encumbrance on the stock, I would make a loan thereon. Yesterday it was rumored on the street that Mr. Atwood had failed, and I went to the Bank of Louisville to have the stock transferred to you, which the cashier refused to do. I thought it my duty to in-

form you of this, so that you can take such steps as your attorney may advise."

Some time afterward the appellant's vice-president, in company with Hurter, called at the Bank of Louisville and demanded a transfer of the stock into the name of appellant, which was refused on the ground that Atwood was indebted to the Bank of Louisville, and that it had a charter lien on its stock for the indebtedness of stockholders to it.

In that interview Hurter stated in substance, that before making the loan he had called on the president and cashier of the Bank of Louisville, and they both told him the bank had no lien on the stock. This they both denied in the presence of appellant's vice-president.

When the note matured the appellant brought suit upon it against Atwood, and it also brought suit against the Bank of Louisville to compel it to transfer the stock. Judgment was recovered against Atwood, on which an execution issued, which was returned "no property found." The Bank of Louisville answered, and set up its lien on the stock, which was adjudged superior to the lien of appellant, and the stock was sold, and failed to satisfy the prior lien, whereby the loan made for the appellant became a total loss.

This action was then brought against the apellee to recover damages for failing to take sufficient security for the loan.

The appellee, in its answer, denied all charges of negligence, and averred that it had acted with due caution and circumspection in making the loan, and also set up and relied upon a ratification of its acts in the matter after the appellant was in possession of all the facts and circumstances connected with the transaction.

A trial resulted in a verdict and judgment for the appellee.

The only ground urged for a reversal is, that the court erred in instructing the jury in respect to the alleged ratification. The evidence showed, without contradiction, that before the appellant received the note and collaterals, and brought suit against Atwood and the Bank of Louisville, it knew that the latter claimed a lien on the stock pledged to secure Atwood's note for an amount exceeding its value. But it also showed that the appellee's cashier informed the appellant, that before the loan was made the Bank of Louisville agreed to release its lien, or, what was the same thing, to transfer the stock on its books into appellant's name.

That the appellee's cashier knew, before he made the loan, that the Bank of Louisville had a lien on its stock for debts due

the bank by the holders thereof, and that Atwood was then indebted to the bank in a sum greatly exceeding the value of the stock, was not at any time disputed, the sole matter in dispute being whether it had agreed to waive its lien when called on by Hurter before he made the loan. That question was never finally settled until the judgment in favor of the Bank of Louisville was rendered.

Upon this evidence the court instructed the jury that if the appellee fairly and fully communicated to the appellant all the facts and circumstances connected with the loan *which were known to the appellee or its agent, Hurter,* and that the appellant knew of the insolvency of Atwood and the claim asserted by the Bank of Louisville, and thereafter adopted the transaction, and received the note and collaterals and treated them as its own, the law was for the appellee, although it might have been guilty of such negligence as would otherwise have rendered it liable.

The doctrine that, if an agent has, by a deviation from his orders, or by any other misconduct or omission of duty, become responsible to his principal for damages, he will be discharged therefrom by the ratification of his acts or omissions by the principal, if made with a full knowledge of all the facts, is elementary. But the instructions given in this case went further, and held that if the principal, at the time of accepting the note and collaterals, knew all of the facts touching the loan and affecting the value of the security, *which were then known to the agent,* and with such knowledge received them and treated them as its own, the agent was discharged from liability. We have examined many authorities, both elementary and judicial, in which the doctrine of ratification, as between principal and agent, is discussed, but we have not found one which considered the good faith of the agent as an element in deciding whether or not there had been a ratification; but, on the contrary, whenever the good faith of the agent has elicited remark, it has been to the effect that it could have no weight in the decision of this question. "Indeed, in all such cases the question is not, whether the party (agent) has acted from good motives and without fraud, but whether he has done his duty and acted according to the confidence reposed in him." (Story on *Agency,* sec. 192.)

Nor do we find any authority for exonerating a delinquent agent from liability if he communicates to the principal all the facts known to him at the time and the principal ratifies the delinquency, and it afterwards turns out that the facts as communicated were not the real facts of the case. In such a

case the assumed condition is not that claimed to have been ratified.

It was the duty of the appellee to loan appellant's money on good security, or such as a person of common prudence and skill in business would have esteemed good. . . .

The gravamen of the appellant's complaint is, that the appellee negligently failed to take sufficient security for the loan; and the defense is, that the alleged negligence has been ratified; and yet the uncontradicted evidence is, that at the time of the supposed ratification it was not known that there had been the slightest negligence, or that the security was insufficient. It was not the act of making the loan that needed to be ratified; that was expressly authorized. Nor did the acceptance of the bank stock as security need ratification. The stock was confessedly worth more than the loan. That which needed ratification was the acceptance of the stock *subject as it was to the lien of the Bank of Louisville* as security for the loan. If, as the appellee affirmed, it was not subject to the asserted lien, there had been no negligence, and there was nothing to ratify. Whether it was subject to that lien was never known until the suit to test the question was decided; and then, and not until then, did the appellant obtain a knowledge of the facts necessary to make an election whether to adopt or repudiate the acts of its agent.

We have found no case, the facts of which are sufficiently like the facts of this, to make the decision rendered a controlling precedent in this case; but assuming the two fundamental rules of the law of agency: (1) that when the agent has deviated from his duty he becomes liable to his principal for such losses as are the direct and natural consequence of such deviation, whether his motives were good or bad; and (2) that he is only released from that liability when the principal, with a knowledge of all the facts, ratifies his departure from his duty, and we think there can be no doubt of the correctness of the conclusion we have reached.

There was not only no evidence that the appellant knew at the time of the alleged ratification that the appellee had taken insufficient security, but, on the contrary, the evidence was uncontradicted and conclusive that it did not, and there was therefore no evidence upon which to base an instruction on the subject of ratification. . . .

It is also claimed that the appellee had no authority to act as agent in loaning money, and is therefore not liable even if guilty of negligence in the matter.

The appellee is an incorporated bank, and we are unable

to discover in its charter anything which prohibits it from engaging in any business incident to general banking. The answer presented no issue upon the point, and we cannot say as matter of judicial knowledge, that the loaning of money for a customer is not a part of the legitimate business of general banking. Whether it is or not, is a question of fact depending upon the custom of banks, and if it was intended to rely that such business was *ultra vires* the bank, the issue should have been made in the answer in order that the appellant might offer evidence to show that it was incidental to the business of banking, and therefore within the implied powers of the appellee.

It seems to us therefore that on the pleadings and evidence embodied in the record, the only question involved was whether the appellee used that care and skill in taking security which, under the circumstances, it was its duty to use.

If, in view of the character and standing of Atwood at the time the loan was made, the knowledge the appellee (or what is the same thing, its cashier) had of the lien on the collaterals given to the Bank of Louisville by its charter, what took place between the appellee's cashier and the officers of the Bank of Louisville, and his information as to Atwood's indebtedness to it, the loan would not have been made on the security taken by a person of ordinary prudence and skill in banking, the appellee is liable, otherwise it is not.

Judgment *reversed,* and cause remanded for a new trial upon principles not inconsistent with this opinion.[1]

§388 *WILLIS v. MUSCOGEE MANUFACTURING COMPANY.*

Supreme Court of Georgia, 1904. [120 *Ga.* 597.]

SIMMONS, C. J.: Willis brought suit for damages against the Muscogee Manufacturing Company, alleging that the defendant had wrongfully reported him to certain other companies as having left its service in violation of one of its rules, and that, because of such report, such other companies had, under an agreement with the defendant, refused to give him employment. The evidence introduced by the plaintiff was substantially as follows: In 1902 several cotton-mill companies in Muscogee county, Georgia, among them the defend-

[1][If, however, there is a valid ratification by the principal, the agent is discharged from liability and the principal's attempted revocation of the ratification because of unfavorable developments, is inoperative. See *Symanski v. Plassan* (1862), 20 La. Ann. 90. EDRS.]

ant, agreed to make and post in their mills a rule requiring employees, when leaving the employment of a company, to "work a six days' notice." They also agreed to report to each other all employees who left their employment without complying with such notice, and, except in special cases, not to employ men so reported. In pursuance of this agreement the defendant posted in its mill the following notice: "All employees of this mill must work a six days' notice when leaving the employ of this mill, and no employee of any other cotton-mill of Columbus and vicinity will be employed by this mill unless they have worked the required notice." This rule had been in operation for several months when Willis, the plaintiff, obtained employment of the defendant. Plaintiff was perfectly familiar with the rule, and, while he was boss in another mill, had reported other operatives for its violation. He had worked for several of the mills which were parties to the above-mentioned agreement, and for the defendant, prior to 1902, and had in each case, when leaving one mill for another, worked out the required notice. Plaintiff was a "loom fixer," and as such was employed by the proper officer of the defendant. The officer agreed to employ plaintiff at $1.50 per day to repair Crompton looms, but, according to the plaintiff's testimony, it was expressly understood that he was not to work at that price on Crompton and Knowles looms combined. Plaintiff worked for some time on the Crompton looms, and was then directed by an officer of the company to repair some Crompton and Knowles looms combined. Plaintiff asked at what price, and was told that he would receive but $1.50 per day. When he refused to work on these looms at that price, the defendant's officer told him it was all he would give, and that if plaintiff would not do the work for that price he could quit. The work on these combined looms was more difficult than that on the others, and was worth more per day. After this conversation with the defendant's officer, plaintiff considered himself discharged. He left and applied to other companies for employment. He was refused, because the defendant had sent his name to the other companies on what was called the "blacklist," in which it was stated that plaintiff had left the service of the defendant without cause and without working the required six days' notice. Plaintiff endeavored to obtain employment from the other companies, but failed, and, according to his contention, his failure was the result of the report of the defendant sent to the other companies. Finally, at a cost of some $40, he had to remove from Columbus to Griffin, where he obtained work. There was some conflict in the evidence as to whether the other companies

refused to employ plaintiff because of the report sent out by the defendant, or for other reasons. At the conclusion of the evidence for the plaintiff the court granted a non-suit. To this judgment the plaintiff excepted.

1. All manufacturing companies, and as well all other persons who employ labor, have the right and power to make reasonable rules and regulations for the government of their employees. It is reasonable to require that employees shall give their employers a certain number of days' notice before leaving their service. It has been held to be reasonable to require such notice and to provide that if the notice is not given, the employee shall forfeit all wages then due him. The rule in the present case was reasonable, and one who, with knowledge of the rule, entered the service of the defendant was bound by the rule. It entered into his contract of service and became a part of it, as binding upon him as any other part of his contract. Manufacturing corporations frequently make large contracts for goods to be delivered at a specified time. In order to comply with these contracts it is necessary for them to keep the requisite number of employees in their service. If employees were allowed to leave their employment without giving any notice, it would in many cases be impossible for the employers to fill their places in time to complete the goods according to the contracts made for their delivery. With six days' notice of the intention of an employee to leave, the employer would have a reasonable time to fill his place. For these and other reasons we think that the rule was a reasonable one.

2. It was contended by counsel for the plaintiff in error that, while the rule may have been a reasonable one when adopted by a single corporation, it was an unlawful conspiracy for a number of corporations to join in an agreement to enforce such a rule by reporting violations of it to each other and refusing to employ any person who had been so reported. We cannot see the force of the reasoning of counsel on this point. We see no reason why the officers of a dozen cotton-mills in or near the same city cannot make such an agreement with each other. An employer has a right to select his employees according to what standard he may choose, though such standard be arbitrary or unreasonable. An employer certainly has a right to refuse to employ any one whom he knows to have left another employer in violation of a reasonable rule which both employers are seeking to enforce. An agreement among a number of employers to report such violations and thus assist each other in the selection of their

employees is not unlawful, though coupled with an agreement to employ no one so reported, such an agreement not being binding upon the employers, and there being no allegation that it was entered into through malice. See *Baker v. Ins. Co.* (Ky.), 55 L. R. A. 271; *Brewster v. Miller's Sons* (Ky.), 38 L. R. A. 505; *Boyer v. Tel. Co.,* 124 Fed. 246; 8 Cyc. 645 *et seq.*

3. There are, however, limitations upon the rights of the employers in this matter. While the employee is bound by the reasonable rules of the employer, as a part of the contract of employment, and may be reported to other employers for a breach of those rules, there is a correlative duty upon the employer not to report an employee wrongfully. The rule which enters into the contract of employment is as much a part of the contract of the employer as of the employee, and both are bound by it. The employer is strictly within his rights as long as he reports no employee for a violation of the rule except such as have actually violated it. When, however, he wrongfully makes such a report and an employee is thereby damaged, such employee has a right of action. While the corporations which entered into the agreement above described had a right to do so, they owed a duty to their employees not to abuse that right. If one of them falsely reported an employee, to his injury, such employee may recover for the tort. The combination of the employers was a powerful machine for the accomplishment of lawful results, but it was capable of misuse to the injury of innocent employees. When a company so misuses it, such company must take the consequences.

4. Our difficulty has arisen, not in coming to the above conclusions, but in applying them to the facts of the present case so as to determine whether the trial judge erred in granting a non-suit. It was contended by counsel for the plaintiff in error that the rule as to six days' notice did not apply to the facts of this case, and that, instead of "leaving" his employer, plaintiff was discharged by defendant; that he had made a contract to do certain work on a certain kind of loom at a stipulated price, expressly excepting from the agreement work on the combined looms which he stated he would not do for the price paid for the work contracted for. Without his consent an officer of the defendant ordered him to work on the combined looms without any addition in his wages. This, he claims, was a change in his contract, to which he refused to accede, and he was then told he could quit. In consequence of this declaration by the defendant's officer, he gathered up his tools, etc., and left. The other companies were then notified by defendant that plaintiff had left its employment with-

out cause and in violation of the rule as to giving notice. On the other hand, the defendant claims that the evidence shows that the plaintiff left its service voluntarily and refused to work out the required notice, and that the defendant was, therefore, justified in reporting him to the other companies as having violated the rule. This we think was a question of fact which should have been submitted to the jury. There was enough evidence to require that the case be submitted to a jury. If the jury had found favor of the plaintiff on this issue, he would have been entitled to recover some damages. When one promulgates an ambiguous or doubtful rule, it must be construed strictly against him. This rule of construction must be borne in mind in ascertaining whether the regulation as to notice applied to such a case as was made by the termination of the plaintiff's employment. If the employer, who promulgated the regulation, made a mistake in its construction and applied it to a state of facts which did not come within it, the employee injured by such mistake has a right to recover. The employer cannot arbitrarily place an employee upon the blacklist as having violated the regulation, when in point of fact the employee's conduct did not come within the terms of such regulation and he, therefore, had not violated it. On the other hand, if the plaintiff left the service of the defendant voluntarily, without cause and without giving the required notice, or if he had contracted to do all such work in his line as the company might reasonably require of him, without excepting work upon the combined looms, and then refused to work upon these looms for the agreed price per day, and left because defendant would not give him more, then the defendant had a right to report him as having left without cause and without working out the required notice. It was also contended by the plaintiff that this report to the other companies prevented his obtaining other employment, and compelled him, in order to obtain work, to remove to another city; that he thus lost time and was put to actual expense by reason of his having been reported by the defendant. The defendant claimed that the agreement between it and the other companies was voluntary and not legally binding on any of them, and that any one of the other companies could have employed plaintiff had it seen proper to do so, and that, in truth, the notice sent out to the other companies was not the real cause of the plaintiff's failure to get work. Under the evidence this was also a question for the jury, and not for determination by the court. We therefore think that the court erred in granting a non-suit.

Judgment reversed. All the justices concur.

§389. *Rules as Element of Contract.*—On the one side, the agreement between the employers in this case is described as a mere gentleman's agreement, not enforceable by the parties. On the other hand, the rules made with reference to it are looked upon as incorporated in the contract between the employer and employee. It is significant of the contractual theory of employment that the rules laid down by the employer are given effect by this court merely as contracts, and therefore as binding on the employer as well as on the employee.

This suggestion should be borne in mind in the making of rules for the management of a business. Unless there is a stipulation to the effect that the rules are subject to change, employers can no longer consider themselves in the position of legislators within their own domain under such decisions, but merely as contractors.

It is interesting to notice in this case the extra-legal machinery created for the purpose of enforcing the contractual obligation of the employees. Just because legal machinery is cumbersome and employees generally not responsible, employers find it advisable to stipulate for the retention of back pay and for publication of the shortcomings of employees, very much as creditors in the past created their extra-legal safeguards described in Chapter X of this work.

§390. *KEIT'S CASE.* [*Quoted in* 3 *Salkeld* 47].[1]—A master may justify the beating his apprentice, servant, scholar, etc., if the beating is in nature of correction only, and with a proper instrument, otherwise *immoderate castigavit* is a good reply. And so it was adjudged in *Keit's case*, per HOLT, Ch. Just. Assault and Battery; the defendant justified, for that the plaintiff was his apprentice, and that he

[1]Is this case connected with the criminal case reported as *Rex v. Keit*, 1 Lord Raymond, 138 (1696)? In the course of his opinion Lord Holt said, "If a master gives correction to his servant, it ought to be with a proper instrument, with a cudgel, etc., and then, if by accident, the blow gives death, this would be manslaughter; the same law of a schoolmaster. But a sword is not a proper instrument for correction and the cruelty of the act will make a malice implied, and therefore, in this case, if Wells had not been killed, Keit could not have justified this fact in an action of trespass, for it was immoderate correction."

tempore quo, etc., gave him gentle correction, and traversed that he was guilty at any time before or after he was his apprentice; and upon a demurrer to this plea it was adjudged ill, because the defendant ought to show some cause specially, or the fault for which he beat his apprentice, and then conclude *absque hoc* that he beat him before or after that time. . . .

§391. *The Change from a Domestic to a Business Relation.*—So long as the relation between master and servant was a domestic relation, the *forum domesticum,* under the sanction of a kind of self-help doctrine, furnished the model for discipline within the business organization. Has this entirely disappeared? If so, how and when? See Cooper, *Flagellation, A History of the Rod.*

A clue to this development may be found in the analogy of the case of seamen who were originally treated like apprentices. See *The Agincourt* (High Court of Admiralty, 1824) 2 Hagg. 271.

Public Laws of the United States, 1850. (St. Sept. 28, c. 80, Sec. 1; Rev. St. 1878, Sec. 4611.) Flogging on board vessels of commerce is hereby abolished. Id. 1862. (St. July 17, c. 204, Sec. 1, Art. 18; Rev. St. 1878, Sec. 1624, Art. 49.) In no case shall punishment by flogging . . . be inflicted upon any person in the Navy.

The development of juvenile courts and reform schools in recent years has removed some of the most serious of the problems of the *forum domesticum* to another forum. In business life, very naturally, a much greater share of the serious disputes requiring correction has gone over to the courts, excepting in small, backward communities where we are occasionally reminded of the old régime by such tragedies as that mentioned in *State v. Shaw* (1902), 64 S. Car. 566.

B. In Partnership

§392. *Uniform Partnership Act.*—Section 18.—(Rules determining Rights and Duties of Partners.)—The rights and duties of the partners in relation to the partnership shall be

determined, subject to any agreement between them, by the following rules:

(a) Each partner shall be repaid his contributions, whether by way of capital or advances to the partnership property, and share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied; and must contribute towards the losses, whether of capital or otherwise, sustained by the partnership according to his share in the profits.

(b) The partnership must indemnify every partner in respect of payment made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business or for the preservation of its business or property.

(c) A partner, who in aid of the partnership makes any payment or advance beyond the amount of capital which he agreed to contribute, shall be paid interest from the date of the payment or advance.

(d) A partner shall receive interest on the capital contributed by him only from the date when repayment should be made.

(e) All partners have equal rights in the management and conduct of the partnership business.

(f) No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.

(g) No person can become a member of a partnership without the consent of all the partners.

(h) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without the consent of all the partners.

Section 19.—(Partnership Books.)—The partnership books shall be kept, subject to any agreement between the partners at the principal place of business of the partnership, and every partner shall at all times have access to and may inspect and copy any of them.

Section 20.—(Duty of Partners to Render Information.)—Partners shall render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or partner under legal disability.

Section 21.—(Partner Accountable as a Fiduciary.)—(1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transactions connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

(2) This section applies also to the representatives of a deceased partner engaged in the liquidation of the affairs of the partnership as the personal representatives of the last surviving partner.

Section 22.—(Right to an Account.)—Any partner shall have the right to a formal account as to partnership affairs.

(a) If he is wrongfully excluded from the partnership business or possession of its property by his co-partners,

(b) If the right exists under the terms of any agreement,

(c) As provided by Section 21,

(d) Whenever other circumstances render it just and reasonable.

Section 23.—(Continuation of Partnership Beyond Fixed Term.)—(1) When a partnership for a fixed term or particular undertaking is continued after the termination of such term or particular undertaking without any express agreement, the rights and duties of the partners remain the same as they were at such termination, so far as is consistent with a partnership at will.

(2) A continuation of the business by the partners or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is *prima facie* evidence of a continuation of the partnership.

Section 34.—(Right of Partner of Contribution from Copartners after Dissolution.) Where the dissolution is caused by the act, death or bankruptcy of a partner, each partner is liable to his co-partners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved unless

(a) The dissolution being by act of any partner, the partner acting for the partnership had knowledge of the dissolution, or

(b) The dissolution being by the death or bankruptcy of a partner, the partner acting for the partnership had knowledge or notice of the death or bankruptcy.

§393. *Competing with One's Principal.*—Section 30 of the British Partnership Act declares: "If a partner, without the consent of the other partners, carries on any business of the same nature as and competing with that of the firm, he must account for and pay over to the firm all profits made by him in that business." This is said by Sir Frederick Pollock to be "an elementary rule."

But in the absence of special regulations, there is no legal reason why directors of a corporation should not be interested in other companies, even though they be competing companies.

§394 *BANK OF MONONGAHELA VALLEY v. WESTON.*

Court of Appeals of New York, 1899. [159 *N. Y.* 201.]

VANN, J.: . . . The plaintiff was put upon inquiry as to the other notes, as they were presented by the maker. The remainder of its claim, therefore, depends upon the implied authority of William to make accommodation indorsements in the name of his firm. According to the evidence we think this was a question of fact, as we have already held in *Smith v. Weston,* 159 N. Y. 194, a companion to the case in hand, and argued in connection therewith. The testimony, which came mainly from Abijah and Orren Weston, who were interested witnesses, presented a singular state of facts, as the jury might have found. For about ten years two members of the firm of Weston Brothers knew that the third was constantly using the firm name for the accommodation of friends. Having the power to prevent it they took no effective steps to do so, but let the public run the risk of loss through his indorsing in the name of the firm. They repeatedly remonstrated with him in private, and he always promised to stop, but never kept his promise, and they had reason to believe not only that he did not intend to keep it, but that he knew they did not expect him to keep it. If, upon the first discovery, they had warned him and he had not only promised, but had also lived up to his promise, no question of fact would have arisen. Perhaps there might be more latitude than this without presenting a question of fact, but a systematic and persistent course of conduct, known to the defendants, calls in question their good faith. They had no right to assume that William would do otherwise in the future than he had in the past. If a son should forge his father's name, to his knowledge, for a series of years, mere private expostulation would not save the father from liability.

It would be necessary for him to take some public action for the protection of innocent persons. (*Weed v. Carpenter*, 4 Wend. 219, and 10 Wend. 404.) If Abijah and Orren Weston, knowing that the public was liable to be injured, preferred that William should keep on indorsing rather than disgrace him by exposure, they must take the consequences, for the sanctity of commercial paper and respect for the rights of third persons will not permit the business community to be imposed upon by their negligence if a jury finds, under all the circumstances, that the negligence was so persistent as to amount to ratification. Failing to stop him, or to give notice of any kind, after repeated offenses, is evidence of acquiescence in and ratification of his course. They cannot rest on their objections and his promises, under the facts disclosed, without subjecting their good faith to the scrutiny of a jury. Resistance may be so feeble as to be evidence of acquiescence, and persistent acquiescence is evidence of implied consent. They knew that it did no good to talk to him upon the subject, and that outside parties were liable to be victimized by their failure to act. If they had not given him six months' time in the spring of 1891, the plaintiff could not have acquired the paper in suit. If they meant what they said, why did they not act accordingly? Did not mere remonstrance finally become submission? Did they not encourage him to continue? Did not both his course and theirs lead him to understand that if he continued to do in the future what he had repeatedly done in the past, to their knowledge, it would meet with the same treatment only in the future that it had in the past? When they threatened dissolution or exposure if he indorsed without authority again, why did they not keep their word if they were sincere? Why did they have the same stereotyped conversation every few months, for year after year, accept the same promise and condone its violation, with unvarying regularity, if they were acting in good faith? Did they prefer that innocent persons should suffer loss rather than hurt their brother's feelings? Did they keep silent when it was their duty to speak? Were they making evidence to protect themselves if William finally went too far and they concluded to repudiate? Was their story, as a whole, probable, and was the jury bound to believe it? These inquiries, which bear upon the main question of good faith, acquiescence and ratification, were for the consideration of the jury, and we think the trial court erred in not submitting the case to them for consideration. Juries have a right to look between the lines of the evidence and infer what a man's inten-

tion was from his conduct, beyond the positive testimony in a case.[1]

§395. *Complete Dissolution or Acquiescence the Legal Alternative.*—Paradoxical as it may seem to speak of remonstrances that are so feeble as to amount to ratification, this comment on the facts of the above case offered by the court seems quite apt and suggestive. The case brings into strong relief the difference between the affairs of partners among themselves and the relation between those partners as a group to the rest of the world. Even dissolution, if not properly brought to the notice of strangers, may be ineffective. Though the *penchant* of William in this case for signing accommodation paper for his friends may not be a common occurrence in business, still the peculiarities of partners to which other members of the firm may object seems to be uncontrollable by any halfway measures. The only alternatives are a complete dissolution or to take matters as they are.

In this case, the court discusses the business interest of the public which it seeks to protect under the heading of the sanctity of commercial paper. The presence of commercial paper, however, merely intensifies the necessity which exists in all kinds of transactions in the business world to permit men to act with reasonable dispatch on the general assumption that things are as they are presented to be on their face. The law of agency and partnership have this principle in common, though to a less degree, with the law of bills and notes. Why do business men seem to insist upon the jural postulate that a man in business shall have the benefit of a general assumption that things are as they seem without a necessity of investigating the facts of each particular case? The law, it must be remembered, has not created this demand. On the contrary, it accords it only a partial and somewhat grudging recognition.

§396 *HAGGETT v. HURLEY.*

Supreme Judicial Court of Maine, 1898. [91 *Me.* 542.]

EMERY, J.: . . . Partnership is often called a contract, as marriage is often spoken of as a contract, but it is rather a relation, a status, somewhat as marriage is a relation or status. Parsons on *Principles of Partnership,* §101.

In a partnership there are no opposite parties with separate and different interests in the subject-matter of the partnership.

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[1]Opinion continued in §420, *infra.*

There is a community of right and interest. Neither partner owns any proportional part of any article of partnership property; each has dominion over the whole article and over the entire partnership property. Upon the death of either partner this dominion remains in the survivors. So long as the partnership continues, no right of action at law exists between partners as to any partnership property or transaction. Much like marriage partners, business partners are left to adjust themselves to one another as best they can until they call upon the courts to dissolve the relation and administer the estate. Again, in a partnership there is a notion of an entity apart from the individual partners. In the Roman law the partnership was known as "*societas.*" There is individual property and partnership property. A partner may owe the partnership and *vice versa.* A partnership usually has dealing and keeps accounts with each partner. In those jurisdictions where the Roman law is the basis of the jurisprudence, the entity of the partnership is frankly recognized and actions are allowed between the partner and the partnership. *Succession of Pilcher,* 39 La. Ann. 362. *Liverpool, etc., Navigation Co. v. Agar,* 14 Fed. Rep. 615.

In common law jurisdictions this entity is acknowledged, at least in equity, and to some extent at law, in spite of the technical rule that no action at law can be maintained between a partner and a partnership. *Pooley v. Driver,* 5 Ch. Div. 458; *Curtis v. Hollingshead,* 14 N. J. L., 402, p. 410; *Walker v. Wait,* 50 Vt. 668. . . .

§397. *The Civil Law and the Commercial Ideas of Partnership.*—The statement in *Haggett v. Hurley* about the partnership entity in Roman law is in need of modification. There are two kinds of partnership in Roman law countries,—the civil and the commercial. Unfortunately, when Story wrote his widely influential work on partnership in Anglo-American law, the commercial partnership had not been fully developed on the Continent and Story was influenced by the civil partnership conception. In the civil partnership, there is no entity theory; its principles are based on the analogy of co-heirs at Roman law, who own property in common and all of whom have certain powers with reference to that property. The commercial partnership, on the other hand, is a business creation very much like our corporation.

Suppose that partnership goods are fraudulently used by one partner to settle a debt due from him individually to the defendant: May the injured partner maintain an action at law for damages against the defendant? See *Reed v. Gould* (1895), 105 Mich. 368, answering the question in the negative. The relief, if any, must be by a bill in equity against the wrong-doing partner and the purchaser.

C. In Corporations

§398. *Contract of Corporation with its own Director.* 1 *Va. Law Rev.* 66.—"As to the validity of a contract between a private corporation and one of its directors, there appears to be much difference of opinion. Three distinct views have been advanced:

I. According to one view the directors, by the mere fact of being directors, are not disqualified from entering into contracts with the corporation, provided there are enough directors on the other side of the contract (representing the corporation), to make a quorum, and further provided that the contract is fair, open and honest. Such contracts, whenever they come up for review, are carefully scrutinized by the courts, and indeed it may be said that they are regarded with suspicion, but are generally held valid of themselves, the essential feature of the inquiry going wholly to the question of good faith.[2] The director so interested *quoad* the contract itself ceases to be a director and becomes a stranger to the transaction.[3] In consequence, no contract made by a bare quorum which includes the director so interested can be upheld, because the quorum is automatically broken by the disability of the director to vote on matters in which he has a personal interest.[4] Still, even where the contract is executed by a true quorum the burden of

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[1] *Porter v. Lassen County Land Co.*, 127 Cal. 261, 59 Pac. 563.

[2] *Twin Lick Oil Co. v. Marbury*, 91 U. S. 587; *Barr v. Plate Glass Co.*, 57 Fed. 86, 6 C. C. A. 260, 17 U. S. App. 124; *Smith v. Skeary*, 47 Conn. 47; *Louisa County National Bank v. Traer* (Ia.), 16 N. W. 120.

[3] *Stratton v. Allen*, 16 N. J. Eq. (1 C. E. Green.) 229.

[4] *Bennett v. St. Louis Car Roofing Co.*, 19 Mo. App. 349; *Butts v. Wood*, 37 N. Y. 317.

proof is upon the interested director to show the open and fair nature of the transaction.[5]

II. The second view is that a director cannot enter into contractual relations with his corporation, any more than he can have any pecuniary interest in a contract between his corporation and a third party, and that any such pretended contract is void *ab initio* for illegality. This view is not upheld by the authorities. In some cases there was actual fraud on the part of the majority of the directorate in making the contract in which some of the directors (not counted in the quorum) were interested.[6] In others there was no disinterested quorum.[7] In still others actual fraud, or at least strong suspicion of fraud on the part of the interested directors, caused the court to refuse to uphold the contract.[8] In the case of *Twin Lick Oil Co. v. Marbury*,[9] the Supreme Court of the United States expressly repudiates this view.

III. The third, and it would seem the true, as well as the most generally accepted rule, is that such contracts may be made by a corporation, with one or more of its directors, or with a corporation or firm in which such director is interested, provided that it is done openly, by a quorum of disinterested directors, and with the express or implied assent of the stockholders. If this assent be withheld the contract is voidable within a reasonable time by the *cestuis que trustent*.[10] Such assent may be by formal ratification, or may be implied from long acquiescence therein by the stockholders.[11] After ratification of, or long continued acquiescence in, the contract by the stockholders, it becomes binding and cannot thereafter be

[5] *Pitman v. Chicago Lead Co.*, 93 Mo. App. 592, 67 S. W. 946; *Ryan v. Williams*, 100 Fed. 172.

[6] *Thomas v. Brownsville & Ft. K. Ry.*, 2 Fed. 877.

[7] *Smith v. Los Angeles, etc., Ass'n*, 78 Cal. 289, 20 Pac. 677.

[8] *Haywood v. Lincoln Lumber Co.*, 64 Wis. 639, 26 N. W. 184; *Flint & Pere Marquette Ry. Co. v. Dewey*, 14 Mich. 477.

[9] *Supra.*

[10] *Stewart v. Lehigh Valley Ry. Co.*, 38 N. J. Law (9 Vroom) 505; *Griffith v. Blackwater Boom & Lumber Co.*, 46 W. Va. 56, 33 S. E. 125; *Jesup v. Ry. Co.*, 43 Fed. 483.

[11] *Warren v. Para Rubber Shoe Co.*, 166 Mass. 97, 44 N. E. 112; *Hodge v. U. S Steel Corporation*, 64 N. J. Eq. 807, 54 Atl. 1.

avoided.[12] If the directors or other interested officers own a majority of the stock, mere ratification by the majority is not sufficient, and the transaction may be reviewed in equity, at the instance of the minority.[13] If the contract is partly performed and then avoided by the *cestuis que trustent,* the director is allowed to recover for the reasonable value of his services, etc., under the contract, provided he has acted in good faith throughout.[14] But the burden of ascertaining and of proving the amount reasonably due is on the director himself.''[15]

§399. *Note on Corporation's Right to Avoid Transactions With Directors, in* 25 *Harv. L. Rev.* 553.—''The determination of a corporation's right to avoid transactions in which any of its directors are adversely interested, and which have not been ratified by the shareholders, raises problems somewhat similar to those presented in the analogous situation of transactions between an ordinary principal and his agent.[1] It is established doctrine that in the latter case the principal can avoid the transaction if any unfairness was practiced upon him by the agent;[2] but if the agent acted fairly, the transaction is not voidable,[3] even in the extreme case where the agent represented both himself and his principal.[4] Similarly a corporation can avoid a transaction in which any of its directors were adversely interested, if they acted unfairly.[5] But when the directors

[12]*Battle v. Northwestern Cement & Paving Co.*, 37 Minn. 89, 33 N. W. 327; *Gorder v. Plattsmouth Canning Co.*, 36 Neb. 548, 54 N. W. 830

[13]*Booth v. Land, etc., Imp. Co.*, 68 N. J. Eq. 536, 59 Atl. 767.

[14]*Griffith v. Blackwater Boom & Lumber Co., Supra.*

[15]*Booth v. Land, etc., Imp. Co., supra.*

[1]A peculiar problem is presented by contracts of corporations to vary the duties imposed upon their directors, not by contract, but by the relation of directorship. Such contracts may be obnoxious for some reason of policy not applicable to all contracts between corporations and their directors. This special class of contracts, so far as it is affected by such a rule of policy, is not dealt with in this note.

[2]*People on Relation of Plugger v. Township Board of Overseers,* 11 Mich. 222.

[3]*Rochester v. Levering,* 104 Ind. 562, 4 N. E. 203.

[4]*Burke v. Bours,* 98 Cal. 171, 32 Pac. 980.

[5]*Hoffman Steam Coal Co. v. Cumberland Coal & Iron Co.,* 16 Md. 456; *Electric Light Co. v. Bates,* 68 Vt. 579, 35 Atl. 480.

acted with entire fairness, it is not so easy to achieve a result identical with that in the analogous case of the ordinary principal. A more stringent rule may be required for corporate transactions in which directors are adversely interested, because the latter have far greater opportunity to practice unfairness upon their principal than have ordinary agents. This increased danger of unfair dealing is due to the greater control which a director has over his principal and the other agents of his principal,[6] and to the fact that it is impossible for a director to give notice of his adverse interest to his principal, an indispensable requirement for fair dealing by an agent with an ordinary principal.[7] Do these two difficulties necessitate a rule allowing a corporation to avoid any contract in which its directors are adversely interested, irrespective of the fairness of the latter? The lack of such a rule will to some extent permit, in spite of the closest scrutiny by the courts, the exercise of fraud upon corporations by their directors.[8] But the existence of such a rule will deprive corporations of some measure of the freedom enjoyed by ordinary principals in doing business and choosing agents; for the possibility of subsequent avoidance by the corporation of transactions in which its directors are adversely interested will discourage both dealings by directors with their corporations and acceptance of directorships by those desirous of dealing with the corporation or of serving other corporations dealing with it. That these considerations, and especially the former, are of importance, is illustrated by those cases in which a corporation, refused aid by everyone but its directors, has been saved from insolvency only by dealings with them.[9]

The difficulty of determining whether a corporation will be damaged more by the unfair dealing of its directors or by the curtailment of the corporation's transactions with its directors and of its choice of directors has resulted in a conflict of au-

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[6]An instance of the exercise of such control is *Pickett v. School District*, 25 Wis. 551.

[7]*Burke v. Bours*, 92 Cal. 108, 28 Pac. 57.

[8]See *Stewart v. Lehigh Valley Co.*, 38 N. J. L. 505, 522. But see *Wyman v. Bowman*, 127 Fed. 257, 273.

[9]*Tatem v. Eglanol Mining Co.*, 42 Mont. 475, 113 Pac. 295.

thority, largely confined to a conflict between the cases of different periods. Most of the earlier decisions adopted the doctrine of viodability of all transactions, irrespective of their fairness.[10] A recent decision is one of the many later holdings to the contrary, which have largely displaced the older view. *Wainwright v. P. H. & F. M. Roots Co.* 97 N. E. 8 (Ind.). Thus, by the growing weight of authority transactions of corporations, in which transactions any,[11] or even a majority,[12] of its directors are adversely interested, whether as contracting parties or as directors of the other contracting party,[13] cannot be avoided by the corporation if no unfairness was practiced upon it by the directors adversely interested."

[For a note on the law regarding contracts between corporations having common directors or officers, see 33 L. R. A. 788. The Clayton Act, approved Oct 15, 1914 (38 U. S. Stat. at L. 730), forbids interlocking directorates in certain cases.—EDRS.]

§400 *STEWART v. HARRIS.*

Supreme Court of Kansas, 1904. [69 *Kan.* 498.]

ATKINSON, J., delivered the opinion of the court:

On January 5, 1901, A. B. Harris sold to John T. Stewart, for $2,000, 12 shares of the capital stock of the Wellington National Bank. Harris subsequently brought this action against Stewart to recover the difference between the amount he received for the stock and its actual value at the time he sold it to Stewart. Judgment for plaintiff on the verdict and findings of a jury. Defendant prosecutes error.

Defendant, at the time he purchased the stock of plaintiff, was president of the bank and the holder of a majority of the stock. He had been president of the bank continuously since 1893. As such president he was actively engaged in the management of the affairs of the bank. Plaintiff was a man over eighty years of age, and retired from active business. He had

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[10] *Wilbur v. Lynde & Hough,* 49 Cal. 290; *Munson v. S., G. & C. R. Co.,* 103 N. Y. 58, 8 N. E. 355. It should be noted that *Aberdeen R. Co. v. Blaikie Bros.,* 1 Macq. 461, an early case usually cited in this connection, is a Scotch case.

[11] *Beach v. McKinnon,* 148 Fed. 734; *Vonnoh v. Sixty-Seventh St. Atelier Building,* 55 N. Y. Misc. 22, 105 N. Y. Supp. 155.

[12] *Wyman v. Bowman, supra; Tatem v. Eglanol Mining Co., supra.*

[13] *Leavenworth v. Chicago, etc., Ry. Co.,* 134 C. S. 688, 10 Supt.

never engaged in the business of banking, or a like business. He had never attended a meeting of the stockholders of the bank. The petition in substance charged that through his agent, T. F. Randolph, defendant purchased the stock of plaintiff; that defendant at the time was president of the bank, engaged in the active management of its affairs; that he withheld from plaintiff a knowledge of the affairs of the bank; that by fraud and by concealing from plaintiff the real condition of the affairs of the bank, defendant obtained the stock at much less than its actual value. A recovery was asked for the difference between the amount received and the actual value of the stock at the time of the sale. Defendant's answer, in substance, denied he withheld from plaintiff the information requested, denied he had procured the shares of stock from plaintiff by fraud or concealment, denied under oath the agency of Randolph, and averred that plaintiff had, or could have obtained upon inquiry, full knowledge of the condition and affairs of the bank at the time he sold the shares of stock. Defendant was charged with undertaking and carrying out a scheme to so manipulate and manage the condition and affairs of the bank as to enable him to acquire the stock of the bank at a price grossly inadequate to its real value. . . . Plaintiff, before selling the stock, went to defendant and inquired about the condition of the bank, and asked if dividends would be paid. Defendant informed him the bank would pay no dividends. He told him the bank was in good condition, but that the policy was to strengthen it. He related to plaintiff the bad condition the affairs of the bank were in at the time he took charge of it. He also told him of the large amount of paper the bank had then charged off. Defendant gave to plaintiff no further knowledge or information of the affairs of the bank than to say to plaintiff that the bank was in a good condition. Defendant at two different times himself made a proposition to purchase the stock of plaintiff, on one occasion offering plaintiff $1,000 for his stock, and, about two weeks before he purchased the stock through Randolph, offered plaintiff $1,400 for it. Plaintiff received from defendant, through his agent, Randolph, $166 per share for his 12 shares of bank stock. At that time it was worth $350 per share. . . .

The general rule applicable to a purchase and sale between parties who sustain to each other a confidential or fiduciary relation appears to be that, to sustain the sale, the buyer must show affirmatively that the transaction was conducted in perfect good faith, without pressure of influence on his part, and with express knowledge of the circumstances and entire freedom of

action on the part of the seller. The rule is applied with more or less strictness to all the well-known cases of fiduciary relation, as that of attorney and client, trustee and *cestui que trust*, principal and agent, guardian and ward. *Dunn v. Dunn*, 42 N. J. Eq. 431, 7 Atl. 842; 8 Am. & Eng. Enc. Law, p. 644. In *Oliver v. Oliver*, 118 Ga., 362, 45 S. E. 232, the right of plaintiff to a recovery was conceded, where defendant, the president and director of a corporation, purchased of plaintiff his holdings of stock in the corporation at $110, worth at the time $185, per share. The action was brought to recover of defendant the difference between the amount by plaintiff received for the stock, and the value of the stock at the time of the sale. It was charged that defendant in the purchase of the stock withheld from plaintiff information, known to defendant and unknown to plaintiff, relative to its value, which, owing to the fiduciary relation existing between the parties, it was the duty of defendant to have disclosed to plaintiff. It is a well-considered case. Many features of it are applicable to the case under review. We quote from the opinion the following: "It is a matter of common knowledge that the market value of shares rises and falls, not only because of an increase or decrease in tangible property, but by reason of real or contemplated action on the part of managing officers, upon declaring or passing dividends, upon the making of fortunate or unfortunate contracts, the loss or gain of property in dispute, and on profitable or disadvantageous sales or leases; and to say that a director, who has been placed where he himself may raise or depress the value of the stock, or in a position where he first knows of facts which may produce that result, may take advantage thereof, and buy from or sell to one whom he is directly representing, without making a full disclosure, and putting the stockholder on an equality of knowledge as to these facts, would offer a premium foı faithless silence, and give a reward for the suppression of truth. It would sanction concealment by one who is bound to speak, and permit him to take advantage of his own wrong,—a thing abhorrent to a court of conscience. It is conceded that the position which the director occupies prevents him from making personal gains at the expense of the company, or of the whole body of stockholders. But the rule that he is not trustee for the individual shareholders inevitably leads to the conclusion that, while a director is bound to serve stockholders *en masse*, he may antagonize them one by one; that he is an officer of the company, but may be the foe of each private in the ranks. When it is admitted, as it must be, both from the very nature of his duty and from the rulings of nearly all the cases, that

he is trustee for the shareholder, how is it possible, in principle, to draw the line, and say that, while trustee for some purposes, he is not for others immediately connected therewith?"

The case of *Tippecanoe County v. Reynolds*, 44 Ind. 509, 15 Am. Rep. 245, is the leading case cited and relied on by plaintiff in error as authority for the claim that the instruction under consideration, given by the court, does not correctly state the law. It was in that case held there was no relation of trust between the president and director of a corporation and a stockholder of such corporation; that, in the absence of actual fraud, a purchase of stock by the former from the latter was valid, though in his official position the president knew at the time he purchased the stock it was worth more than its nominal market value, but did not disclose to the stockholder the facts within his knowledge as to its real value. The opinion in the case was by a divided court in 1873. It is bottomed upon the view, announced by the court, that, while the officers and managing agents of a corporation are trustees for the corporation and its corporate property, they sustain no trust relation to the stockholders of the corporation, and owe to them none of the duties of a trust relation. Other cases are cited taking the same view, and apparently following the Indiana case, the pioneer case to announce the doctrine. The rule laid down by the Indiana case has met with much criticism. The position taken by that court leaves the stockholder's interest in the corporation and all matters affecting its value wholly in the charge and keeping of the managing officers, of the corporation, and leaves the stockholders of the corporation their legitimate prey. We cannot give the sanction of our approval to the views expressed by the Indiana court in that case. The fact that the directors and managing officers of a corporation are quasi trustees of the stockholders does not prohibit them from dealing with such stockholders. The only restriction is that in such dealing their conduct must be fair, open and above reproach. Because of the trust relation and the better opportunities afforded for acquiring information, before any director or managing officer of a corporation having a knowledge of the condition of the affairs of such corporation can rightfully purchase the stock of one not actively engaged in the management of its affairs, such director or managing officer must inform such stockholder of the true condition of the affairs of the corporation. . . .

We have read the entire record, and examined the assignments of error. Finding no substantial error in the record, *the case will be affirmed.*

All the Justices concur.

§401. *Relation of Director to Stockholder.*—The preceding case is representative of the minority view; the prevailing view is that a director is under no duty to a stockholder with whom he is bargaining for the purchase or sale of stock, to volunteer information affecting the value of the shares of the corporation. *Cf. Cowell v. Jackson* (1891), 53 N. J. L. 656; *Percival v. Wright* [1902], 2 Ch. 421; *Hooker v. Midland Steel Co.* (1905), 215 Ill. 444.

§402 *BOWDITCH v. JACKSON CO.*

Supreme Court of New Hampshire, 1912. [76 N. H. 351.]

BILL IN EQUITY, to enjoin a sale of the assets of the Jackson Company to the Nashua Manufacturing Company. The plaintiffs are stockholders of the Jackson Company and allege in their bill that, through control exercised by common directors, the defendants were about to execute a conspiracy to sell the assets of the Jackson Company to the Nashua Company for an inadequate price, payable in Nashua Company stock; that in furtherance of this conspiracy, the officers had procured the assent of the holders of 460 of the 600 shares of Jackson Company stock to a trust agreement whereby they were irrevocably bound for one year to vote for the sale; and that a meeting of the stockholders had been called to consider the proposed action. In the superior court, *Wallace, C. J.*, ordered the injunction, but later so far modified it as to permit holding the meeting and passing the votes as to the sale, the same to be effective if the injunction was thereafter dissolved. The hearing on the merits was had before *Plummer, J.,* who reported the facts and transferred the case without ruling from the May term, 1911, of the superior court.

In the fall of 1910, committees of the boards of directors of the two companies were appointed to consider the advisability of the sale and purchase. They reported recommending such sale on the basis of the Nashua Company paying in its own stock at the rate of one and a half shares of $500 par value for each share of Jackson Company stock of $1,000 par value. After this recommendation was made, holders of 446 shares of Jackson Company stock entered into a trust agreement whereby their stock was transferred to certain trustees to hold the same for one year, to vote it for the proposed sale, and to distribute the proceeds of the sale and take necessary steps to wind up the company. Aside from these particulars, the trustees were left free to exercise their judgment in voting the stock, but were to

make no substantial change in the business or condition of the corporation, except as above specified.

After the injunction was modified, a meeting of Jackson Company stockholders was held, at which it was voted (subject to the injunction proceedings, to make the sale and wind up the company, to sell the stock of the Nashua Company not taken by Jackson Company stockholders, and to distribute the proceeds among them. At this meeting 490 shares were voted in favor of the sale and 104 against it. Of the 490 shares, 446 were voted by the trustees and the balance by individual holders or their proxies. The plaintiffs protested the legality of the action.

The market value of the Jackson Company stock has been and is $975 a share, and that of the Nashua Company stock, $650. After the sale was voted, a standing offer was secured from the American Trust Company of Boston to take the Nashua Company stock not taken by the Jackson Company stockholders at $650 a share. The price to be paid to the Jackson Company stockholders is adequate, and the proposed exchange of stock is equitable. The officers, directors, trustees, and attorneys who were engaged in promoting the sale have acted in good faith and for the best interests of both companies, according to the best of their judgment. All the terms of the proposed transaction are fair and equitable.

PEASLEE, J.: 1. The main question in this case is whether a going business corporation can be closed out and dissolved upon the motion of the majority of its stockholders and against the protest of the minority. The question is a new one in this state, although it has frequently been considered (both in cases where it was necessarily involved and those where it was not) by the courts in other states. The decisions and *dicta* are conflicting and are quite evenly divided. In the following cases the existence of the power is denied, though in most of them the question was not necessarily involved: *Abbot v. Rubber Co.*, 33 Barb. 578; *People v. Ballard*, 134 N. Y. 269; *Kean v. Johnson*, 9 N. J. Eq. 401; *Forrester v. Mining Co.*, 21 Mont., 544. That the power exists is decided or declared in other cases: *Treadwell v. Company*, 7 Gray 393; *Phillips v. Company*, 21 R. I. 302; *Black v. Canal Co.*, 22 N. J. Eq. 130, 404 (overruling *Kean v. Johnson*, 9 N. J. Eq. 401); *Merchants Line v. Wagner*, 71 Ala. 581; *State v. Company*, 115 Tenn. 266; *Tanner v. Railway*, 180 Mo. 1; *Arents v. Company*, 101 Fed. Rep. 338.

The only case in this state having a direct bearing upon the subject is *Dow v. Railroad*, 67 N. H. 1. In that case there

was an attempt to change the business of the corporation; and while any expression of opinion on the question here involved was carefully avoided, yet the opinion of Chief Justice Doe contains an exhaustive and illuminating discussion of the nature of a corporation and the source of the power of the majority to act for it. The majority have the agency which in a partnership each partner possesses. Do they, in addition thereto, have the power each partner has to compel a dissolution? The corporation being an outgrowth of the law of partnership, it would be reasonable to expect that so important an incident to the joint undertaking as the right to terminate the enterprise would not be lost by the change in the form of the association. The fiction that the corporation is a being independent of those who are associated as its stockholders is not favored in this state. *Dow v. Railroad, supra,* 3. Decisions based upon the idea that there is something sacred in the life of an ordinary business corporation, so that action looking to its extermination is in the nature of fraud upon the state (*People v. Ballard,* 134 N. Y. 269), are not authority in a jurisdiction where a different view of the nature of the association is entertained. The question is not one of power granted by the state. It relates solely to the agreement of individuals with each other.

Did the stockholders who united to form the Jackson Company in 1830 understand that the business must be continued perpetually, provided a profit could be made and some stockholder objected to closing it out, or did they understand that the enterprise could be brought to an end at such time as the majority believed to be for the best interest of all concerned? The latter seems the more reasonable and probable conclusion.

Much has been said in the cases upholding the right of the minority to prevent a sale and dissolution, concerning the protection of their rights and saving their property from pillage by the majority. Just how the majority, which sells its own property at the same time and for the same price it sells that of the minority, gains an advantage over the latter is not readily apparent. Cases might be supposed, and undoubtedly occur, where the majority do obtain some undue advantage from the sale. No one contends that such a sale is valid. But because the power of the majority may be abused, it does not follow that it does not exist. If such a conclusion were to be drawn, minorities would always rule. The plain common-sense of the matter is that this is a business venture, to be carried on as such so long as it appears to be good business judgment to do so. When the time comes that a majority in interest believe

that their affairs should be wound up and the proceeds distributed, the rational rule is that this should be done. And since the question here is of a business nature, and the limitations of the power of the majority are fixed by the understanding of the business men who made the original compact, business considerations have more than ordinary weight in determining what the contract was.

It is admitted on all sides that the majority may sell out if the corporation is insolvent. And when brought face to face with the question whether they must wait until the stockholders' investment is all lost before taking action, the conclusion has been that if insolvency is imminent action may be taken. And the same is true if it is imprudent to continue. 4 Thomp. *Corp.* §4489, and authorities cited. One reason only is given why the power exists in these cases: It is reasonable to suppose that such authority was contemplated, because this is what sound business judgment dictates should be done. The difference between these cases and the present one is of degree only, not of kind. The majority are not obliged to wait until all possibility that the corporation can go on longer has been negatived. Some of the cases have stated that such is the rule; but the result of this would be to compel the majority to continue a losing business until their investment was entirely wiped out. To avoid so absurd a result, it has been said they could close out when insolvency seemed to be approaching. And so various forms of expression have been used to indicate the time when the majority could take action. All these are fairly summed up in the statement that the majority may close out the affairs of the company when it can no longer make a reasonable profit. It is believed no court would now hold that the rights of the minority were more extensive than this rule implies.

If the majority may sell to prevent greater losses, why may they not also sell to make greater gains? Bearing in mind that this is purely a business proposition, with no public rights or duties involved, there seems to be no substantial difference between the two cases, as a matter of principle. In each case, the sale is made because it is of advantage to the stockholders. Whether the profit to be made is a reasonable one, must be a relative matter. Three per cent. when others make two might be reasonable; but three per cent. when a sale could be made which would yield the stockholder ten could hardly be thought an investment a reasonable person would retain. The loss to the stockholder by a failure to sell out on a basis which would yield him ten per cent. instead of the three he is receiving is

in fact much greater than it would be if a concern went on neither making nor losing when the investment would earn four per cent. elsewhere. It does not seem reasonable that the majority should have the power to make a sale in the latter case, and not in the former. In neither case would the sale prevent positive loss, but in each it would result in positive gain. And the question is one of future prospects. Its decision requires the exercise of business judgment, sagacity, and power to forecast coming events. It is not an issue appropriate for trial and decision in courts, but rather one to be settled by the judgment of the men conducting the business in question. In a limited sense, the majority act as trustees for all the stockholders. When their acts are impugned by the minority, it is not the function of the court to set its judgment against theirs in settling the wisdom or policy of proposed action. By the contract of association, all questions of this nature were committed to the majority for final decision. *Gamble v. Water Co.,* 123 N. Y. 91, 99.

The whole difficulty is probably an outgrowth of the early idea that a corporation possessed peculiar attributes of longevity and sanctity. But as pointed out in *Dow v. Railroad,* 67 N. H. 1, 8, 26, no such theory prevails here. The business corporation is brought into being solely for the purpose of more conveniently carrying out the joint undertaking of the part owners. The line of distinction between this form of association and certain partnerships is but a shadowy one. *Ib.* 8. It is not reasonable or natural to expect that when this boundary is passed great changes in the relation of the parties will result. A more radical change than that here claimed could not easily be imagined. In the partnership, one partner may compel a winding up from mere whim. In the absence of an agreement to go on for a fixed period of time, nothing short of a fraudulent purpose will prevent his taking valid action to close out the firm at will. *Fletcher v. Reed,* 131 Mass. 312; Lind. *Part.* 570. By the rule here contended for, the change of the association into a corporation has carried the rule to the opposite extreme. The authority to wind up is lost, and the owner of the smallest share may prevent such action, though it is desired by all his associates. The practical reasons against such proposition are apparent. The probabilities are opposed to the idea that the associates intended to enter into such a compact.

It is urged that the analogy of the partnership right does not apply, because the stockholder can sell his shares and so terminate his connection with a management with which he is dissatisfied. It is true he has this legal right; but it is not true

that it is an adequate remedy, when a majority desire to retire from the business. The proposition is a practical one. It is not disposed of by offering to the majority a naked legal right the exercise of which will probably deprive them of a considerable share of their property. Partnerships are sometimes formed with transferable shares, but this does not impair the right to compel a dissolution. In the case of special or limited partnerships, the rule is that the general law of partnership applies unless modified by statute or special agreement. *Tyrrell v. Washburn*, 6 Allen 466. Accordingly it was held that where shares in the firm were transferable, and additional shares were issued from time to time, a partner who wished to retire could compel a dissolution and winding up of the firm. *Ib.* The fact that (as in a corporation) the dissatisfied owner could sell his shares, was not sufficient to take away his right to other remedies.

The action taken by a majority of the stockholders of the Jackson Company whereby, as a part of the process of winding up the company, they voted to sell all its property to the Nashua Company, was within the power impliedly given to them when the company was formed. The charges that there was fraud in the sale and that it was for an inadequate price have been disproved. Two other causes of complaint remain to be considered.

2. It is urged that because the payment for the property of the Jackson Company was to be made in stock of the Nashua Company, therefore the sale was invalid, because the stockholders never agreed to embark in the Nashua Company's business. It is not necessary to examine this question now. Assuming for the purposes of this decision that the position is well taken, its effect is avoided by the provision that a stockholder may have cash instead of Nashua stock. Arrangement having thus been made whereby any stockholder can receive his share of the proceeds of the company's assets in money, his rights are not infringed by a stipulation (in the benefits of which he can share if he so elects) that stockholders may receive Nashua stock instead of money. *Koehler v. Brewing Co.*, 228 Pa. St. 648.

The plaintiffs now suggest that the Trust Company option is not a sufficient guaranty that the cash will be paid to them. The defendants say that they procured the option as the best available proof of their good faith in making the offer to pay cash to dissenting stockholders. Until it was settled that the agreements were to be carried out, it would not be expected that the money to pay for the stock would be paid over, or

deposited as security. It is assumed that this will now be done by the defendants, under such an order as to details of the transaction as the superior court may make, or the parties may agree upon.

The claim is also made that a purchase by the Jackson Company of Nashua Company stock is *ultra vires* and voidable. But the substance of this transaction is not a purchase of stock by the Jackson Company. That company is to be dissolved, and in the process of dissolution the proceeds of its property are to be divided among its shareholders. The Nashua Company pays $585,000 for the property. Those who desire to receive payment in stock can do so, and cash will be paid to those who do not wish to invest in the stock. So far as the Jackson Company takes the stock at all, it is merely to transfer it to those who elect to take it, or to sell it for the guaranteed price and pay the proceeds to those who wish to receive money instead of stock. If the form of the agreements and offers, taken as a whole, infringes the rule here invoked, the substance is not open to such objection. In such a case equity ought not to interfere.

3. The legality of the votes passed at the meeting of the Jackson stockholders is questioned on account of the nature of the trust agreement under which the majority of the stock was then held, and because the trustees voted more than one-eighth of the entire stock. While the decisions upon the first question are not entirely in accord, yet substantially all of them recognize that an agreement to vote stock in a certain way may be valid. The rule is well stated in the case chiefly relied upon by the plaintiffs. "If the transfer of the legal title to the stock is made and accepted under an agreement of the stockholder which deprives him of all power to direct the trustee, and all opportunity to exercise his own judgment in respect to the management of the affairs of the corporation, then whether the transaction is open to the objection of other stockholders, as depriving them of the right they have to the aid of their co-stockholders, must be dependent upon the purposes for which the trust was created and the powers that were conferred. If stockholders, upon consideration, determine and adjudge that a certain plan for conducting and managing the affairs of the corporation is judicious and advisable, I have no doubt that they may by powers of attorney, or the creation of a trust, or the conveyance to a trustee of their stock, so combine or pool their stock as to provide for the carrying out of the plan so determined upon. But if stockholders combine by either mode to entrust and confide to others the formulation and execution

of a plan for the management of the affairs of the corporation, and exclude themselves, by acts made and attempted to be made irrevocable for a fixed period, from the exercise of judgment thereon, or if they reserve to themselves any benefit to be derived from such a plan to the exclusion of other stockholders who do not come into the combination, then in my judgment such combination and the acts done to effectuate it are contrary to public policy, and other stockholders have a right to the interposition of a court of equity to prevent its being put into operation." *Kreissl v. Distilling Co.*, 61 N. J. Eq. 5, 14.

An examination of the cases generally will disclose that in nearly all of them where the agreement was held invalid there were stipulations or covenants which infringed this rule. The propositions that "it is as legitimate for a majority of stockholders to combine as for other people," and that the combination is unlawful only if "the gain was to be at the expense of the corporation, or in some way was to work a wrong to the other stockholders" (*Brightman v. Bates*, 175 Mass. 105, 110), are generally recognized as sound law. *Chapman v. Bates*, 61 N. J. Eq. 658; *Faulds v. Yates*, 57 Ill. 416; *Smith v. Railway*, 115 Cal. 584. Even the cases holding the particular agreements then under consideration to be invalid usually recognize the proposition that there may be a valid voting trust. *Shepaug Voting Trust Cases*, 60 Conn. 553, 579; *Gage v. Fisher*, 5 No. Dak. 297.

Judged by these standards, the agreement in the present case seems unobjectionable. The trust is to terminate at the end of a year in any event. It contemplates the winding up of the corporation within that time, and sets out in detail the plan of sale and dissolution for which the trustees were authorized to vote. It further provides that the trustees shall not vote so as to substantially change the company's business, except as specifically authorized. There is nothing here which seeks to work a wrong to the corporation, to confer a benefit upon those joining in the trust, or to turn the management of the stockholders' affairs over to strangers. Judged by the strictest rule of a stockholder's right to the free and honest judgment of his co-stockholders, the agreement here made by more than three-fourths of the stockholders is a legitimate arrangement for carrying out their purpose to close out the affairs of the company.

The argument that each stockholder is entitled to the presence of his associates to the end that they shall reason and be reasoned with is not of weight here. The rule of the common law was that no member of a corporation could vote by proxy.

1 Thomp. *Corp.*, s. 875, and cases cited. But the charter of this company introduces a different doctrine. "Absent members may be represented and vote at such meetings by an agent for that purpose duly authorized by writing, signed by the member or members to be represented." Act to establish a manufacturing corporation, by the name of the Jackson Company, 32 Ms. Laws 197 (1830). It is not necessary to now consider what effect the act of 1842, forbidding all proxy voting, giving one vote for each share up to ten, one vote for every two shares between ten and twenty and no more (R. S., c. 146, *s.* 20), had upon this right. *Dow v. Railroad,* 67 N. H. 1, 25, *et. seq.* The act of 1842 was repealed four years later, and the principle of general proxy voting was adopted. Laws 1846, c. 321, *s.* 5. The limitation of the right, incorporated in the revision of 1867 (G. S., c. 134, *s.* 21), was removed in 1901; so that now a proxy can represent more than one stockholder, and one stockholder can be proxy for another. Laws 1901, c. 68. Whether the charter or the general law applies here, the rule is that one or many stockholders may be represented at the stockholders' meeting by an agent. . . . *Case discharged.* All concurred.

§403. *Rights of Minority Stockholders.*—Certain rights the minority shareholders always have; any one of them, for example, has the right to enjoin a threatened *ultra vires* transaction. See *Victor v. Mills,* 148 Ga. 107 (§378, *supra*). It is a very different proposition, however, to say that the minority shall have the power to enjoin a transfer of all the corporate assets and a distribution of the proceeds to the stockholders. This subject has been ably discussed in an article by Professor Edward H. Warren in 30 Harv. L. Rev. 335 (*Voluntary Transfers of Corporate Undertakings*) the concluding paragraphs of which are as follows:

"The right of the minority that there should be no change has always been clear, and conceded by everyone. The right of the majority to terminate has been clouded by misstatements and cumulative misconceptions. But the majority did have that right at common law. Nor has this been essentially altered by the statutes; the statutes may make, for example, two-thirds necessary to a dissolution, where any majority was sufficient at common law; and it may be that such statutes should be construed to require that a sale made as a step preliminary

to dissolution should be authorized in the same manner as a dissolution; but this is the extent of the statutory changes.

"The right of the minority that there shall be no change while the corporation continues to conduct the undertaking must not be infringed, directly or indirectly. But the right of the majority to terminate the conduct of the undertaking by the corporation is entitled to equal respect, and must not be infringed, directly or indirectly.

"This is a subject fit for a treatise. It would be interesting to speak of the lease of corporate assets; of the statutes that have been passed in some states giving the majority a right to purchase the shares of minority stockholders; of agreements that may be included in organization papers which will make plain the right of the majority to sell the corporate assets; and of the possibility of amending organization papers so as to introduce such agreements. But to speak of these matters would be to prolong this article to altogether undue length."

The case of *Bowditch v. Jackson Co.* also raises interesting questions with respect to the voting rights of a shareholder.

Voting is, of course, one of the most effective means of enabling a stockholder to protect his interest in a corporation. The opinion contains a sound discussion of the validity of the so-called voting trust. See further the note on the subject in 18 Col. L. Rev. 123 and the treatise on *Voting Trusts* by Harry A. Cushing.

§404 *ELLSWORTH v. DORWART.*

Supreme Court of Iowa, 1895. [95 *Iowa* 108.]

DEEMER, J.: Plaintiff is now, and for many years has been, a stockholder in the Burlington, Cedar Rapids & Northern Railway Company, a corporation organized under the general incorporation laws of this state. The defendant Dorwart is the secretary and assistant treasurer of this corporation, and the defendant Ives is its president and general superintendent. These officers have charge and control of the books of the corporation which are kept at the company's general offices in the city of Cedar Rapids. On the twenty-first day of April, 1893, the plaintiff applied to the secretary for permission to examine the stock ledger, original record, stock book, transfer book, financial record, and all books and vouchers pertaining to the

financial affairs of the corporation. In compliance with this request, Dorwart produced the stock book and stock ledger, and plaintiff was permitted to examine them for a few moments only; whereupon the defendant Ives directed that the books be taken from plaintiff, refused to permit him to examine them further, and denied him the right to examine any other of the books or vouchers of the corporation. The request was made by plaintiff as a stockholder, at a seasonable time and in a reasonable manner. Plaintiff thereupon brought this action, but his petition was denied by the court and thereupon he prosecuted an appeal to this court. [The court then quotes the pertinent sections.] It would seem from these sections that it is the absolute right of any person to examine the stock and transfer books of a corporation organized under the laws of this state, whether he shows himself interested therein or not; and it likewise appears that a stockholder has the right at all reasonable hours to inspect the records showing the financial condition of the corporation. A strict construction of the statute perhaps does not give him the right to examine the original papers and vouchers, and, if such right exists at all, it is given by a liberal construction of the language used or by the common law. It is difficult for us to see on what theory plaintiff was denied the right to inspect the original record, stock, and transfer books, and the record of the financial condition of the company. The statute quoted plainly confers the right. Plaintiff asked it at a reasonable time, and was denied it, for some reason which is not disclosed.

It is said in appellee's argument that plaintiff requested and prayed for more than he was entitled to, and that they and the court were justified in denying him the right to examine any of the books. We do not think this is the rule. It was the duty of the officer, upon request, to exhibit to plaintiff such books as he was entitled to, although he called for more than he could rightfully demand; and the court was not justified in refusing him all relief because he asked for more than he was entitled to.

It is also said that the granting of the writ rested in the sound discretion of the court, and that, as the court was authorized to find that plaintiff sought the books to gratify an idle curiosity or with some unworthy motive, this court ought not to interfere. Concede that the court had a discretion in the matter, yet it is a legal discretion, which ought not to be abused. The statutes seem to confer the right in absolute terms, and, if it is to be refused in any case, it seems to us it should only be done when it is clearly apparent that the

purpose of asking it is to gratify an idle whim, or to perplex, annoy, or harass the officers having the books in charge. Such intent does not appear in this case; and, if it did, we are not prepared to say that it would warrant the refusal of a statutory right. All that is shown in this connection is that plaintiff did not feel kindly toward Mr. Ives, the president, and that he had commenced some suits against him.

It is also contended that appellant had no right to examine the books at the time he requested it, because he was accompanied by his attorney and a stenographer. This is not a sufficient excuse. Plaintiff had the right to have his attorney with him, and the attorney had a right to an amanuensis. Neither was present for an improper purpose. Each was there to speed and facilitate the investigation. *Foster v. White* (Ala.) 6 South. Rep. 88. As we have seen, the statute does not confer the right to examine the original papers and vouchers of the corporation, and we think that, to entitle plaintiff to it, he should plead and prove that some property right is involved, or that some controversy exists, or that some specific and valuable interest is in question, to settle which an inspection of these documents becomes necessary. *People v. Walker,* 9 Mich. 328. *Stettaner v. Construction Co.* (N. J. Ch.), 6 Atl. Rep. 303.

The court was in error in denying plaintiff the right to examine the original record, stock, and transfer books, and the record of the financial condition of the corporation; and the judgment is reversed.

§405 *DODGE v. FORD MOTOR CO.*

Supreme Court of Michigan, 1919. [204 *Mich.* 459.]

Bill by John F. Dodge and another against the Ford Motor Company and others to compel the declaration of dividends and for an injunction. From the decree rendered, defendants appeal. [The decree, among other matters, required the directors to declare a dividend of $19,275,385.96.]

OSTRANDER, Ch. J., delivered the opinion of the court:

The authorized capital stock of the defendant company is $2,000,000. Its capital, in July, 1916, invested in some form of property, including accounts receivable, was $78,278,418.65, and less liabilities other than capital stock, was more than $60,000,000. Besides this, it had and was using as capital nearly $54,000,000 in cash or the equivalent of cash. . . .

As we regard the testimony as failing to prove any violation of Anti-trust Laws, or that the alleged policy of the company, if successfully carried out, will involve a monopoly other than

such as accrues to a concern which makes what the public demands, and sells it at a price which the public regards as cheap or reasonable, the case for plaintiffs must rest upon the claim, and the proof in support of it, that the proposed expansion of the business of the corporation, involving the further use of profits as capital, ought to be enjoined because inimical to the best interests of the company and its shareholders, and upon the further claim that in any event the withholding of the special dividend asked for by the plaintiffs is arbitrary action of the directors, requiring judicial interference.

The rule which will govern courts in deciding these questions is not in dispute. It is, of course, differently phrased by judges and by authors, and, as the phrasing in a particular instance may seem to lean for or against the exercise of the right of judicial interference with the actions of corporate directors, the context, or the facts before the court, must be considered. This court, in *Hunter v. Roberts, T. & Co.*, 83 Mich. 63, 71, 47 N. W. 134, recognized the rule in the following language: "It is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of the corporation, and to determine its amount. 5 Am. & Eng. Enc. Law, 725. Courts of equity will not interfere in the management of the directors, unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders." . . .

When plaintiffs made their complaint and demand for further dividends, the Ford Motor Company had concluded its most prosperous year of business. The demand for its cars at the price of the preceding year continued. It could make and could market in the year beginning August 1, 1916, more than 500,000 cars. Sales of parts and repairs would necessarily increase. The cost of materials was likely to advance, and perhaps the price of labor; but it reasonably might have expected a profit for the year of upwards of $60,000,000. It had assets of more than $132,000,000, a surplus of almost $112,000,000, and its cash on hand and municipal bonds were nearly $54,000,000. Its total liabilities, including capital stock, was a little over $20,000,000. It had declared no special dividend during the business year except the October, 1915, dividend. It had been

the practice, under similar circumstances, to declare larger dividends. Considering only these facts, a refusal to declare and pay further dividends appears to be not an exercise of discretion on the part of the directors, but an arbitrary refusal to do what the circumstances required to be done. These facts and others call upon the directors to justify their action, or failure or refusal to act. In justification, the defendants have offered testimony tending to prove, and which does prove the following facts: It had been the policy of the corporation for a considerable time to annually reduce the selling price of cars, while keeping up, or improving their quality. As early as June, 1915, a general plan for the expansion of the productive capacity of the concern by a practical duplication of its plant had been talked over by the executive officers and directors, and agreed upon; not all of the details having been settled, and no formal action of directors having been taken. The erection of a smelter was considered, and engineering and other data in connection therewith secured. In consequence, it was determined not to reduce the selling price of cars for the year beginning August 1, 1915, but to maintain the price, and to accumulate a large surplus to pay for the proposed expansion of plant and equipment, and perhaps to build a plant for smelting ore. It is hoped by Mr. Ford that eventually 1,000,000 cars will be annually produced. The contemplated changes will permit the increased output.

The plan, as affecting the profits of the business for the year beginning August 1, 1916, and thereafter, calls for a reduction in the selling price of the cars. It is true that this price might be at any time increased, but the plan called for the reduction in price of $80 a car. The capacity of the plant, without the addition thereto voted to be made (without a part of them, at least), would produce more than 600,000 cars annually. This number, and more, could have been sold for $440 instead of $360, a difference in the return for capital, labor, and materials employed of at least $48,000,000. In short, the plan does not call for and is not intended to produce immediately a more profitable business, but a less profitable one; not only less profitable than formerly, but less profitable than it is admitted it might be made. The apparent immediate effect will be to diminish the value of shares and the return to stockholders.

It is the contention of plaintiffs that the apparent effect of the plan is intended to be the continued and continuing effect of it, and that it is deliberately proposed, not of record and not by official corporate declaration, but nevertheless proposed, to continue the corporation henceforth as a semi-eleemosynary

institution, and not as a business institution. In support of this contention, they point to the attitude and to the expressions of Mr. Henry Ford.

Mr. Henry Ford is the dominant force in the business of the Ford Motor Company. No plan of operations could be adopted unless he consented, and no board of directors can be elected whom he does not favor. One of the directors of the company has no stock. One share was assigned to him to qualify him for the position, but it is not claimed that he owns it. A business, one of the largest in the world, and one of the most profitable, has been built up. It employs many men, at good pay.

"My ambition," said Mr. Ford, "is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back in the business."

"With regard to dividends, the company paid 60 per cent. on its capitalization of $2,000,000 or $1,200,000, leaving $58,000,000 to reinvest for the growth of the company. This is Mr. Ford's policy at present, and it is understood that the other stockholders cheerfully accede to this plan."

He had made up his mind in the summer of 1916 that no dividends other than the regular dividends should be paid, "for the present."

Q. For how long? Had you fixed in your mind any time in the future, when you were going to pay?

A. No.

Q. That was indefinite in the future?

A. That was indefinite; yes, sir.

The record, and especially the testimony of Mr. Ford, convinces that he has to some extent the attitude towards shareholders of one who has dispensed and distributed to them large gains, and that they should be content to take what he chooses to give. His testimony creates the impression also, that he thinks the Ford Motor Company has made too much money, has had too large profits, and that, although large profits might still be earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken. We have no doubt that certain sentiments, philanthropic and altruistic, creditable to Mr. Ford, had large influence in determining the policy to be pursued by the Ford Motor Company —the policy which has been herein referred to. . . .

The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employees, like

the building of a hospital for their use and the employment of agencies for the betterment of their condition, and a general purpose and plan to benefit mankind at the expense of others, is obvious. There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public, and the duties which in law he and his codirectors owe to protesting, minority stockholders. A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.

There is committed to the discretion of directors, a discretion to be exercised in good faith, the infinite details of business, including the wages which shall be paid to employees, the number of hours they shall work, the conditions under which labor shall be carried on, and the price for which products shall be offered to the public.

It is said by appellants that the motives of the board members are not material, and will not be inquired into by the court so long as their acts are within their lawful powers. As we have pointed out, and the proposition does not require argument to sustain it, it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders, and for the primary purpose of benefiting others, and no one will contend that, if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.

We are not, however, persuaded that we should interfere with the proposed expansion of the business of the Ford Motor Company. In view of the fact that the selling price of products may be increased at any time, the ultimate results of the larger business cannot be certainly estimated. The judges are not business experts. It is recognized that plans must often be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture. The experience of the Ford Motor Company is evidence of capable management of its affairs. It may be noticed, incidentally, that it took from the public the money required for the execution of its plan, and that the very considerable salaries paid to Mr. Ford and to certain executive officers and employees were not diminished. We are not satisfied that the alleged motives of

the directors, in so far as they are reflected in the conduct of the business, menace the interests of shareholders. It is enough to say, perhaps, that the court of equity is at all times open to complaining shareholders having a just grievance.

Assuming the general plan and policy of expansion and the details of it have been sufficiently formally approved at the October and November, 1917, meetings of directors, and assuming further that the plan and policy and the details agreed upon were for the best ultimate interest of the company and therefore of its shareholders, what does it amount to in justification of a refusal to declare and pay a special dividend or dividends? The Ford Motor Company was able to estimate with nicety its income and profit. It could sell more cars than it could make. Having ascertained what it would cost to produce a car and to sell it, the profit upon each car depended upon the selling price. That being fixed, the yearly income and profit were determinable, and, within slight variations, were certain.

There was appropriated—voted—for the smelter $11,325,000. As to the remainder voted, there is no available way for determining how much had been paid before the action of directors was taken, and how much was paid thereafter; but assuming that the plans required an expenditure, sooner or later, of $9,895,000 for duplication of plant, and for land and other expenditures, $3,000,000, the total is $24,000,000. The company was continuing business at a profit—a cash business. If the total cost of proposed expenditures had been immediately withdrawn in cash from the cash surplus (money and bonds) on hand August 1, 1916, there would have remained nearly $30,000,000.

Defendants say, and it is true, that a considerable cash balance must be at all times carried by such a concern. But, as has been stated, there was a large daily, weekly, monthly receipt of cash. The output was practically continuous, and was continuously, and within a few days, turned into cash. Moreover, the contemplated expenditures were not to be immediately made. The large sum appropriated for the smelter plant was payable over a considerable period of time. So that without going further, it would appear that, accepting and approving the plan of the directors, it was their duty to distribute on or near the 1st of August, 1916, a very large sum of money to stockholders. . . .

The decree of the court below, fixing and determining the specific amount to be distributed to stockholders, is affirmed. In other respects, except as to the allowance of costs, the said decree is reversed. Plaintiffs will recover interest at 5 per cent.

per annum upon their proportional share of said dividend from the date of the decree of the lower court. Appellants will tax the costs of their appeal, and two-thirds of the amount thereof will be paid by plaintiffs. No other costs are allowed.

Steere, Fellows, Stone, and Brooke, JJ., concur with Ostrander, J.

MOORE, J.:

I agree with what is said by Justice Ostrander upon the subject of capitalization. I agree with what he says as to the smelting enterprise on the River Rouge. I do not agree with all that is said by him in his discussion of the question of dividends. I do agree with him in his concluson that the accumulation of so large a surplus establishes the fact that there has been an arbitrary refusal to distribute funds that ought to have been distributed to the stockholders as dividends. I, therefore, agree with the conclusion reached by him upon that phase of the case.

Bird, Ch. J., and Kuhn, J., concur with Moore, J.

Petition for rehearing denied.

§406 *EDISON v. EDISON UNITED PHONOGRAPH CO.*

Court of Chancery of New Jersey, 1894. [52 *N. J. Eq.* 620.]

On application for the appointment of a receiver, heard on bill and affidavits on the part of the complainants and affidavits on the part of the defendants.

VAN FLEET, V. C.:

The complainants are stockholders of the Edison United Phonograph Company and have filed the bill in this case for the purpose of having the directors of the corporation displaced and this court take control of the corporation, and, through a receiver, manage and direct its business. The special relief that the complainants ask at this time is that the court will find and declare that the corporation has not administered the trust imposed upon it according to law; that a receiver be appointed to carry on its business and to investigate the condition of its affairs and make report, to the end that its business may be continued or wound up according to the condition in which its affairs shall be found. On the argument three grounds were put forward as the basis of the relief asked—*first,* that the corporation is insolvent or will soon become so if its directors do not abandon their present method of conducting its business and adopt the method which the complainants insist should be adopted; *second,* that the directors, by the course of business they are now pursuing, are violating a trust which was imposed upon the corporation when the complainants assigned

their inventions to it; and *third,* that dissensions exist among the directors, as to the most successful mode of carrying on the business of the corporation, of such a character and to such an extent as to make it impossible for the corporation to prosecute its business with advantage to the stockholders.

The Edison United Phonograph Company was organized under a general law of this state, in February, 1890, for the purpose, among other things, of manufacturing, buying and selling phonographs and also of selling and assigning and of licensing others to sell and use patents, patent rights and inventions relating to the manufacture, use and operation of phonographs. Within less than a month after its organization, it became the owner, by purchase and assignment, of all of Mr. Edison's inventions relating to speaking machines, whether secured by letters-patent or not, in every country of the world except the United States and Canada. The assignment also passed to the corporation all extensions of any letters-patent for such inventions which should thereafter be granted. Within about the same time the International Graphophone Company, a New York corporation, owning the patents for a speaking machine called the graphophone, assigned its patents to the defendant corporation. The object which the promoters of the defendant corporation had in view in its formation is apparent. They wanted to vest in a single person, endowed with corporate life for a long number of years, all known inventions for the construction of speaking machines, and thus avoid disputes respecting priority of invention or infringement, and so render the introduction and use of such machines throughout the world less difficult and more profitable than if independent attempts were made to exploit each invention. The corporation was organized with a capital of $1,000,000, divided into ten thousand shares of $100 each. Five thousand shares, representing $500,000, were issued to Mr. Edison in payment for the inventions and other rights transferred by him to the corporation, and a like number of shares were issued, for a like purpose, to the International Graphophone Company. The corporation still holds all the inventions and other property transferred to it by Mr. Edison and the International Graphophone Company, except the right to sell and use speaking machines in the Kingdom of Great Britain and Ireland. That right it sold, in December, 1892, to a corporation organized under the laws of Great Britain for £20,000 in cash and four thousand shares of the stock of the vendee corporation of the par value of £5 each, the cash and stock representing a value in our currency of about $200,000.

The case is destitute of the least proof tending to show insolvency. That, in cases of this kind, is the jurisdictional fact. The court can do nothing—neither issue an injunction nor appoint a receiver—until insolvency is first established. Until that fact is satisfactorily proved, the court has no jurisdiction. *Atlantic Trust Co. v. Consolidated Electric Co.*, 4 Dick, Ch. Rep. 402, 405. The complainants do not claim that the present indebtedness of the defendant corporation exceeds $107,000, nor that its principal assets, consisting of inventions, patents and patent privileges, are not worth all that the corporation paid for them, or that they would not bring, if sold in any market where their value is known, a sum largely in excess of the amount required to pay all the debts of the corporation. The complainants have not attempted, either by their own oaths or the oaths of others, to show the value of these assets. They say, however, that they have the fullest belief in their value, provided their method of utilizing them is adopted. The fact is that both parties to this litigation believe that these assets possess an immense value. They do not disagree as to their value, but the sole point in difference beween them is as to how they can best be utilized. Their difference is one of judgment respecting the most expedient course of business and not in respect to a fact. The complainants say that if the present business policy of the corporation is not abandoned and their policy adopted, their assets will soon become worthless, and then insolvency must ensue; while the defendants, on the other hand, assert with equal confidence, as the result of their best judgment, that to make the business of the corporation a great financial success the corporation must adhere to its present business policy. This is the real point in controversy. Hence it is manifest that the complainants are not asking for appointment of a receiver because the corporation is now actually insolvent, but because of a fear, resting entirely on conjecture, that it will become so at some time in the future. It is too plain to require demonstration that this court has no power to appoint a receiver to wind up a corporation because it is feared or even expected that it will become insolvent at some time in the future. Nothing short of present actual insolvency will warrant the appointment of a receiver for such a purpose.

The affairs of the defendant corporation are subject to the control of a board of nine directors. Two of the nine believe that the most successful mode of carrying on the business of the corporation, and the best way to subserve and promote the interests of its stockholders, is by the establishment of agencies in different parts of the world for the sale and hire of speaking

machines and adopting that as the leading feature of its business. The other seven do not concur in this belief. On the contrary, they believe that the business of the corporation can be made most successful and profitable by the sale of territorial rights, and making that the principal part of its business. Each faction appears to be thoroughly persuaded that its method is the true one, and that the method of the other is injudicious, and that its judgment is wise and that the judgment of the other is fallacious. Neither denies or impugns the good faith and honesty of the other. This suit had its origin in this difference of belief.

The complainants, to show that they have a right to have their method adopted, allege that when Mr. Edison assigned his inventions it was understood by all parties that the corporation should sell and hire instruments and not sell territorial rights, and they contend that, in consequence of such understanding, a trust arose in their favor by which they became entitled to have their method adopted by the corporation as the principal mode of conducting its business. If such an understanding had been fully proved, the proof of that fact would not, in my judgment, have given this court the least authority to displace the managers selected by the stockholders of this corporation and appoint a receiver to seize its property and manage its affairs. On a bill filed for that purpose, this court might, on being convinced by proof that such an understanding had existed, and that it formed a material part of the contract between the parties, engraft the understanding on the contract and require the managers of the corporation to respect it, but that is the utmost the court could do, at least until the managers should manifest a settled purpose to wantonly violate the contract as reformed. But the fact alleged has not been proved. Mr. Edison assigned his inventions by a writing, under seal, which defines with precision his rights and duties and the rights and duties of his vendee. An examination of that writing shows quite conclusively that the understanding alleged has no foundation in fact. . . .

The power of this court to appoint a receiver of a corporation either because it has no properly constituted governing body or because there are such dissensions in its governing body as to make it impossible for the corporation to carry on its business with advantage to its stockholders, I think must be regarded as settled, but I think it is equally well settled that this power is subject to certain limitations, namely, it must always be exercised with great caution and only for such time and to such an extent as may be necessary to preserve the property of

the corporation and protect the rights and interests of its stockholders. As soon as a lawfully constituted and competent governing body comes into existence, whether it is brought into existence by an adjustment of the dissensions or by the election of a new body, and such body is ready to take possession of the property of the corporation and proceed in the proper discharge of its duties, the court must lift its hand and retire. This is the doctrine, as I understand it, which was laid down by Vice-Chancellor Malins in *Featherstone, Cooke and Trade Auxiliary Co. v. Vickers,* 16 Eq. Cas. 298, 303, and which was approved by Chancellor Runyon in *Einstein v. Rosenfeld,* 11 Stew. Eq. 309, and by Chancellor McGill in *Archer v. American Water Works Co.,* 5 Dick. Ch. Rep. 33.

But neither of the grounds, which this doctrine recognizes as sufficient to warrant the appointment of a receiver, exists in this case. The defendant corporation has a lawfully constituted governing body, which is in peaceable possession of all its property, controlling and directing its business regularly and peacefully, in conformity to the judgment of seven of its nine directors. Two of the nine differ in judgment from the other seven. The two believe that the adoption of a different course of business from that which is now pursued would result in larger gains. Both methods are clearly within the purposes and powers of the corporation. Which method shall be pursued, or whether one or both, is a question which the law commits absolutely and unconditionally to the judgment of a majority of the directors. Though somewhat disguised, the real purpose of the bill in this case appears, when critically examined, to be to induce judicial action which shall substitute the judgment of a minority of the directors of this corporation for that of the majority. That cannot be done. It is beyond judicial power. No rule of law is better settled than that which declares that, so long as the directors of a corporation keep within the scope of their powers and act in good faith and with honest motives their acts are not subject to judicial control or revision. Perhaps no better statement of this principle can be found than that which Vice-Chancellor Green made in *Ellerman v. Chicago Junction Co.,* 4 Dick Ch. Rep. 217, 232, when he said: "Stockholders cannot question, in judicial proceedings, corporate acts of directors, if the same are within the powers of the corporation, and, in furtherance of its purposes, are not unlawful or against good morals, and are done in good faith and in the exercise of an honest judgment. Questions of policy of management, of expediency of contracts or action, of adequacy of consideration not grossly disproportionate, of lawful

appropriation of corporate interests, are left solely to the honest decision of the directors if their powers are without limitation and free from restraint. To hold otherwise would be to substitute the judgment and discretion of others in the place of those determined on by the scheme of incorporation.'' The same principle was restated by the same Vice-Chancellor in *Sewell v. East Cape May Beach Co.*, 5 Dick. Ch. Rep. 717, 723. And Chancellor McGill, in *Benedict v. Columbus Construction Co.*, 4 Dick. Ch. Rep. 23, 36, expressed it in these words: ''If stockholders in a corporation disapprove of the company's management, which is conducted without fraud, or by action not *ultra vires*, or not in gross abuse of trust, or shall consider their speculation a bad one, their remedy is to elect new officers or sell their shares and withdraw. Where the question is one of mere discretion in the management of corporate business, or of doubtful event in the undertaking in which the corporation had embarked, remedy cannot be had by application to a court of equity.''

These utterances leave nothing more to be said. Complainants' application must be denied, with costs.[1]

§407. *Removal of Officers of a Corporation.*—The removal of the officers of a corporation is not a power vested in courts. On the other hand, courts will decree the dissolution of a partnership for certain causes (see Uniform Partnership Act, §32), and such a dissolution of course affects the authority of partners in certain ways (see Uniform Partnership Act, §§33 and 35).

§408 *CONTINENTAL SECURITIES CO. v. BELMONT.*

Court of Appeals of New York, 1912. [206 *N. Y.* 7.]

CHASE, J.: This is a representative action derived from the Interborough Rapid Transit Company. It is brought in behalf of the plaintiffs and all others similarly interested, as stockholders of said company, against the directors of said company and said company to require said individual defendants to account to said company for fifteen thousand shares of its capital stock, alleged to have been issued fraudulently and illegally, and without any valid or adequate consideration therefor, but upon an alleged consideration that was a pretense and subter-

[1] See *Will v. United Lankat Plantations Co.* (1912), 2 Ch. 571; affirmed [1914] A. C. 11; with which contrast *Steinbergh v. Brock* (1909), 225 Pa. 279. Discussed by Dr. Thompson in 19 Mich. L. Rev. 463.

fuge and intended to cover a gift or bonus to the defendants Belmont and Luttgen, and their nominees, and also the require said individual defendants to account for the dividends which have been paid on said stock. It is alleged that by reason of the facts set forth in the complaint the defendant corporation has suffered damage to an amount exceeding $4,500,000. . . .

It is conceded that an action in equity cannot be maintained by the plaintiffs as individual stockholders for themselves and all others similarly interested unless it is necessary because of the neglect and refusal of the corporate body to act.

It is necessary, therefore, in an action by the plaintiffs to set forth two things, *first,* a cause of action in favor of the corporation with the same detail of facts as would be proper in case the corporation itself had brought the action; *second,* the facts which entitle the plaintiff to maintain the action in place of the corporation. (*Kavanaugh v. Commonwealth Trust Co.* 181 N. Y. 121, 73 N. E. 562; *O'Connor v. Virginia Passenger & Power Co.* 184 N. Y. 46, 76 N. E. 1086.)

It is not seriously contended that the complaint does not state a good cause of action in favor of the defendant corporation. It is insisted by the defendants that it was necessary for the plaintiffs in addition to alleging a demand upon the defendant corporation and its board of directors to bring the action and their neglect and refusal to do so, to allege that they had given notice of the alleged fraud to the body of stockholders of the defendant corporation and had demanded of said stockholders that some action be taken by them to redress the wrong, and that such body of stockholders had neglected and refused to take any action relating thereto. The cause of action belongs to the corporate body and not to the plaintiffs, and other stockholders individually, nor to the body of stockholders collectively.

The board of directors represents the corporate body. It is provided by statute in this state that the affairs of every corporation shall be managed by its board of directors. (General Corporation Law, §34.) The directors are not ordinary agents in the immediate control of the stockholders. The directors hold their office charged with the duty to act for the corporation according to their best judgment, and in so doing they cannot be controlled in the reasonable exercise and performance of such duty. The corporation is the owner of the property, but the directors in the performance of their duty possess it and act in every way as if they owned it. (*People v. Powell,* 201 N. Y. 194, 94 N. E. 634.) They are trustees clothed with the power of controlling the property and managing the affairs of a corporation without let or hindrance. As to third

persons, they are its agents, but as to the corporation itself, equity holds them liable as trustees. (2 Pomeroy's *Equity Jurisprudence,* §§1061, 1073, 1088, 1097; *People v. Powell, supra.*)

The claim of the appellants that the body of stockholders has some immediate or direct authority to act for the corporation or to control the board of directors in the matters set forth in the complaint is based upon an erroneous conception of the duties and powers of the body of stockholders in this state. As a general rule stockholders cannot act in relation to the ordinary business of a corporation. The body of stockholders have certain authority conferred by statute which must be exercised to enable the corporation to act in specific cases, but except for certain authority conferred by statute, which is mainly permissive or confirmatory, such as consenting to the mortgage, lease or sale of real property of the corporation, they have no express power given by statute. They are not by any statute in this state given general power of initiative in corporate affairs. Any action by them relating to the details of the corporate business is necessarily in the form of an assent, request or recommendation. Recommendations by a body of stockholders can only be enforced through the board of directors, and indirectly by the authority of the stockholders to change the personnel of the directors at a meeting for the election of directors. Such action may or may not result in securing adequate, corporate action with reference to illegal or fraudulent acts. For reasons wholly apart from the matter in dispute the stockholders may not desire to change a majority of the persons comprising its board of directors. Some of the reasons why the power vested in stockholders to elect directors is inadequate as a remedy for specific fraudulent acts are stated by Cook in his work on *Stock and Stockholders,* §740, in which he says: "There has been considerable discussion as to whether the stockholder in addition to his request to the corporate officers to institute the suit, should not also be required to attempt to induce the stockholders in meeting assembled to take action by directing the directors to bring suit, or by refusing to re-elect them at the next election. The facts, however, that the stockholders in meeting assembled cannot control the discretion of the directors in bringing such a suit; that the remedy of refusing to re-elect them involves delay, and the assumption that a minority of the stockholders can by the election control such a suit; that irreparable injury or the vesting of great financial interests may occur in the meantime; and that laches may arise as a bar to the stockholder's suit, have settled the rule that the stockholder's request to the corporate

directors to institute the suit is sufficient. He need not also apply to a stockholder's meeting." Although it is said that the authority of stockholders in the management of business corporations is exhausted when they elect the directors (Thompson on *Corporations,* 2nd ed., §1178) nevertheless it is generally recognized that certain acts of boards of directors that are legal, but voidable, can be ratified and confirmed by a majority of the body of the stockholders as the ultimate parties in interest and thus make them binding upon the corporation. (Morawetz on *Corporations,* 2d ed., §§625, 626.) Such recognized authority in stockholders to ratify and confirm the acts of boards of directors is confined to acts voidable by reason of irregularities in the make-up of the board or otherwise or by reason of the directors of some of them being personally interested in the subject-matter of the contract or act, or for some other similar reason which makes the action of the directors voidable. No such authority exists in case of an act of the board of directors which is prohibited by law or which is against public policy. (*Kent v. Quicksilver Min. Co.* 78 N. Y. 159.) In any case where action is taken by stockholders confirming and ratifying a fraud and misapplication of the funds of the corporation by the directors or others the action is binding only by way of estoppel upon such stockholders as vote in favor of such approval. (Morawetz on *Corporations,* 2d ed., §625.) The distinction between acts that can and those that cannot be confirmed and ratified is shown in the report of two frequently cited English decisions, namely, *Foss v. Harbottle,* 2 Hare 461, and *Bagshaw v. Eastern Union Ry. Co.,* 7 Hare 114. The former of these cases was limited to the approval of a legal but voidable act. In the Bagshaw case where the directors of a corporation had misapplied or were about to misapply certain moneys of the corporation, the court say: "No majority of the shareholders, however large, could sanction the misapplication of this portion of the capital. A single dissenting voice would frustrate the wishes of the majority. Indeed, in strictness, even unanimity would not make the act lawful. This appears to me to take it out of the case of *Foss v. Harbottle,* to which I was referred. That case does not, I apprehend, upon this point, go further than this: That if the act, though it be the act of the directors only, be one which a general meeting of the company could sanction, a bill by some of the shareholders on behalf of themselves and others, to impeach that act, cannot be sustained, because a general meeting of the company might immediately confirm and give validity to the act of which the bill complains."

It is the governing body or bodies of a corporation with power to enforce a remedy to whom complaining stockholders must go with their demand for relief. The governing body of corporations in this state, as we have seen, is the board of directors. A complaining stockholder must go to such board for relief before he can bring an action, unless it clearly appears by the complaint that such application is useless. If the subject-matter of the stockholder's complaint is for any reason within the immediate control, direction or power of confirmation of the body of stockholders, it should be brought to the attention of such stockholders for action, before an action is commenced by a stockholder unless it clearly appears by the complaint that such application is useless.

The decision reported in *Hawes v. Oakland,* 104 U. S. 450, 26 U. S. (L. ed.) 827, and other similar decisions in the Federal and state courts are not in conflict with the decision about to be rendered herein. In such cases, as in this case, it is asserted that an application to the body of stockholders is unnecessary when it is unreasonable to require it. If the body of stockholders has no adequate power or authority to remedy the wrong asserted by the individual stockholders it is unreasonable and unnecessary to require an application to it to redress the wrong before bringing a representative action. (See opinion of Carr, J., in the appellate division herein, 150 App. Div. 298, 135 N. Y. S. 635. See, also, *Delaware & H. Co. v. Albany & S. R. Co.,* 213 *U. S.* 435.) . . .

CHAPTER XIV

DISSOLUTION AND ACCOUNTING

A. In Agency.

§409 *BLACKSTONE v. BUTTERMORE.*

Supreme Court of Pennsylvania, 1866. [53 *Pa. St.* 266.]

[Buttermore gave to one Davidson a power of attorney to sell the land in question, such instrument declaring that "this authority is irrevocable before the first day of May next." In April, Davidson sold the land to plaintiff, but defendant refused to perform. There was evidence that defendant had revoked the power before the sale to plaintiff, and that plaintiff had notice of the revocation. The court charged that the power was revocable, and that if it was revoked and plaintiff had notice of it before he entered into articles of agreement for the purchase of the land, he could not recover.]

AGNEW, J.: We have decided the substantial point in this case at the present term upon the appeal of Hartley and Minor from the Orphans' Court of Greene County, opinion by Thompson, J., 53 Pa. St. 212.

A power of attorney constituting a mere agency is always revocable. It is only when coupled with an interest in the thing itself, or the estate which is the subject of the power, it is deemed to be irrevocable, as where it is a security for money advanced or is to be used as a means of effectuating a purpose necessary to protect the rights of the agent or others. A mere power like a will is in its very nature revocable when it concerns the interest of the principal alone, and in such case even an express declaration of irrevocability will not prevent revocation. An interest in the proceeds to arise as mere compensation for the service of executing the power will not make the power irrevocable. Therefore, it has been held that a mere employment to transact the business of the principal is not irrevocable without an express covenant founded on sufficient consideration, notwithstanding the compensation of the agent is to result from the business to be performed and to be measured

by its extent. *Coffin v. Landis,* 10 Wright, 426. In order to make an agreement for irrevocability contained in a power to transact business for the benefit of the principal binding on him, there must be a consideration for it independent of the compensation to be rendered for the services to be performed. In this case, the object of the principal was to make sale solely for his own benefit. The agreement to give his agent a certain sum and a portion of the proceeds, was merely to carry out his purpose to sell. But what obligation was there upon him to sell, or what other interest beside his own was to be secured by the sale? Surely his determination to sell for his own ends alone was revocable. If the reasons for making a sale had ceased to exist, or he should find a sale injurious to his interests, who had a right to say he should not change his mind? The interest of the agent was only in his compensation for selling, and without a sale this is not earned. A revocation could not injure him. If he had expended money, time, or labor, or all, upon the business intrusted to him, the power itself was a request to do so, and on a revocation would leave the principal liable to him on his implied *assumpsit.* But it would be the height of injustice if the power should be held to be irrevocable merely to secure the agent for his outlay or his services rendered before a sale. The following authorities are referred to: *Hunt v. Rousmanier,* 8 Wheat. 174; Story on *Agency,* §§463, 464, 465, 468, 476, 477; Paley on *Agency,* 155; 1 Parsons on *Cont.* 59; *Irwin v. Workman,* 3 Watts, 357; *Smyth v. Craig,* 3 W. & S. 20.

The judgment is therefore affirmed.

§410. *Right to Terminate Distinguished from Power to Do So.*—We must carefully distinguish between the right to terminate an agency and the power to do so. A legal power has been defined as the capacity to change rights. Such a capacity does not necessarily involve the possession of a right on the part of the person vested with the power. It may, indeed, be exercised wrongfully and its legal effects may still be the same as if exercised rightfully, though the parties so exercising it may be liable in an action for damages. Thus, an agent acting within the apparent scope of his employment, but beyond the actual scope, has the power to bind his principal though he is liable to his principal for any damages resulting. In like manner, either the principal or the agent may, in most cases, terminate an agency without notice and without any reason, pro-

vided care is taken to protect the public from error, though either may be liable to the other for having wrongfully terminated the agency contrary to a binding agreement.

§411 *THE FARMER'S LOAN & TRUST CO. v. WILSON.*

New York Court of Appeals, 1893. [139 *N. Y.* 284.]

Appeal from judgment of the General Term of the Supreme Court in the second judicial department, entered upon an order made May 9, 1892, which affirmed a judgment in favor of plaintiff entered upon a decision of the court on trial at Circuit without a jury.

This was an action to recover rent claimed to be due under a lease.

The facts, so far as material, are stated in the opinion.

O'BRIEN, J.: The plaintiff, as general guardian of infants, heirs and devisees of one William Maden, has recovered judgment against the defendant for rent claimed to be due under a lease of certain real estate, executed in the lifetime of the testator. Maden died in Cuba on the 6th of August, 1884, having by will devised the real estate in Brooklyn, the rent of which was claimed in this action, to his infant children, who are represented by the plaintiff. He had been for many years before his death a resident of Cuba, and the owner of the real estate in question. The will was duly proved and established under the laws of that country on the 27th of August, 1884, and such proceedings were afterwards had here that it was admitted to record in the office of the surrogate of New York on the 10th of June, 1885, and the plaintiff was appointed guardian December 19, 1888. The real estate had been for many years managed and rented by an agent of the owner, who acted under a verbal authority. The judgment was for rent accruing under the lease subsequent to the death of the owner from the month of September, 1884, to and including the month of May, 1885. It is undisputed that the defendant paid all the rent claimed to the agent subsequent to the death of his principal, but as it does not appear that the agent ever accounted for the same, the sole question presented by this appeal is whether the defendant is protected by such payment in this action.

On the 8th of April, 1884, the testator by his agent, and the defendant, executed the lease which appears to be under seal, acknowledged and recorded. By this instrument Maden, who is described as "of Cortenas, Island of Cuba," demised to

the defendant for the term of five years from May 1 thereafter the buildings in respect to which the rent is claimed to have accrued, at the yearly rent of $3,500, payable monthly in advance. The lease contains a provision for renewal for five years, at $4,000 per year, payable in like manner. The defendant, on his part, covenanted to pay the rent as stipulated and to surrender the premises at the expiration of the term. The defendant had, during the four years prior to the execution of this lease, occupied the premises as tenant under agreement with the agent, and had paid the rent to him, and it appears that the defendant never had any personal dealing with the owner, though he knew he was in fact the landlord and where he resided. At the time that the defendant paid the rent in question to the agent neither of them had any knowledge or information in regard to the death of the owner.

The rule is well settled by authority that the power of an agent to collect and receive payment of rents falling due to his principal, when such power is not coupled with an interest, terminates and ceases upon the death of the principal, and that payment made thereafter to the agent does not bind the estate of the principal, though the payment be made in ignorance of the principal's death. (*Weber v. Bridgman,* 113 N. Y. 600.) The rule seems to have originated in the presumption that those who deal with an agent knowingly assume the risk that his authority may be terminated by death without notice to them. The case of an agency coupled with an interest is made an exception to the rule. (*Grapel v. Hodges,* 112 N. Y. 419; *Hunt v. Rousmanier,* 8 Wheat. 204.) It is urged that the exception applies to this case for the reason that the agent was entitled to commissions upon the rents collected, and to be allowed his disbursements for repairs, insurance, and taxes. The trial court refused to find that he had such an interest as would prevent the revocation of the power upon the death of the principal. There was no proof to show that the agent, at the time of the death, had any claim on account of repairs, insurance or taxes, and, therefore, it is needless to inquire how far, if at all, these elements, if shown to exist, would change the case. It may be assumed that the agent was entitled to compensation for his services, in the form of commissions, upon the money collected, while the agency was in force. But this would not give him such an interest as would continue his power after his principal's death. Agents are quite frequently paid by commissions upon sales of property, or upon moneys collected, and to hold that this constitutes such an interest as would save the power from revocation by the death of the principal, would be, in

effect, to abrogate the rule in most cases. The interest which can protect a power after the death of the person by whom it was created, must be an interest in the thing itself. The power must be engrafted upon some estate or interest in the thing to which it relates. (*Hunt v. Rousmanier, supra.*) Here the agent had no estate or interest in the property nor in the rents as such. The most that can be said is that he was entitled to commissions upon what was to be produced by the exercise of the power, and hence it cannot be said that the power and the interest are united in the same person at the time of their creation. It cannot, we think, be claimed for a moment that the principal, in the creation of the power, conferred upon the agent any interest in the subject to which it was intended to relate. At no time could the agent act except in the name of his principal, and a power thus limited must necessarily cease with the death of the person in whose name it is to be exercised. The learned counsel for the defendant in an interesting and ingenious argument, has attempted to take this case out of the operation of the general rule, but, while much impressed with the equity of his position, we have not been able to make any satisfactory distinction between the facts as they appear in the record and those that appeared in the cases to which reference has been made. The result which we feel constrained to reach will illustrate how a rule or principle of law will operate harshly and produce what might seem to be injustice in a particular case. This conclusion must, however, be modified when we consider that either the defendant or the infant children of the deceased must bear the loss which has occurred by the default of the agent. The defendant could have foreseen what has happened and protected himself against loss by insisting upon payment to the owners alone, or by proper stipulations in the lease. There can be no doubt that a party may by his contract, estop his personal representative or his estate from recovering money paid to his agent in good faith, after his death, under such circumstances as appear in this case, but we see no reasonable way that the children of the owner, who are the real plaintiffs in this case, could have avoided the result. The presumption that every man knows the law implies that they will act with reasonable caution and vigilance in their business affairs, and that in entering upon contracts or carrying them out they will become informed by competent advice of the risks and dangers that beset them. When a man knowingly deals with the agent of a principal who resides in a foreign country, it must be assumed that he will guard against the perils that the transaction necessarily in-

volves, and while courts are disposed to exercise all their power to relieve parties who have acted in good faith, from the result of their neglect to provide, in the first instance, against accidents which might have been foreseen, there seems to be no way open for such a result in this case, without disregarding or refining away an important rule of law. This would practically be judicial legislation. We feel bound to follow the current of authority, and to leave the work of reforming the law on this question, if reform be necessary or desirable, to the legislature.

There would seem to be an incongruity in the law of agency with respect to the effect of a revocation of the agent's powers by the act of the principal himself and a revocation produced by his death. In the former case, the revocation does not affect third parties, dealing with the agent in good faith, without notice. (*Claflin v. Lenheim*, 66 N. Y. 301; *Williams v. Birbeck*, Hoff. Ch. 359; *Blake v. Garwood*, 42 N. J. Eq. 276; Wharton on *Agency*, §§99-104; Story on *Agency*, §470.) While in the latter, as we have seen, the revocation operates upon all parties, without notice, unless the power is coupled with an interest, in which case the agent may execute it in his own name, notwithstanding the death of the principal. The civil law protected third parties who dealt in good faith with the agent without notice in all cases, whether the power was revoked by the act of the principal or his death, but as Chancellor Kent has observed this equitable principle does not prevail in the English law (2 Kent *Com.*, 13th ed., 646), from which the rule that obtains in this state was derived, though in other jurisdictions, and perhaps in England, the harshness of the common law has been modified by statute. (*Weber v. Bridgman*, *supra*, p. 602.) The common-law rule has become too firmly established in this state to be disturbed by judicial action, though a change by the law-making power would be in harmony with more enlightened views and would promote the interests of justice.

The judgment must, therefore, be affirmed, with costs.

All concur.

Judgment affirmed.

§412 *DEWEESE v. MUFF.*

Supreme Court of Nebraska, 1898. [57 *Neb.* 17.]

NORVAL, J.:

On July 1, 1892, Catherine Muff executed a note whereby she promised to pay to the order of James E. Jones the sum of $2.000 on September 1 of the same year, with interest

thereon at seven per cent. per annum. The payee resided in England, but the note was delivered to him personally at Crete, Nebraska; at which time he stated, in substance, to Mrs. Muff in the presence of one J. H. Gruben, her business manager, that he would probably sell the note to C. C. Burr of Lincoln, as he, Jones, was going to England and desired to take the money with him, and that the maker should pay the note to Mr. Burr. The latter had been and then was the agent of Mr. Jones. Instead of selling the note, the payee, soon after it was given, indorsed the same in blank and delivered the instrument to Mr. Burr for collection. On September 19, 1892, Mrs. Muff paid $1,000 on the note to Mr. Burr, and on November 11, 1892, she paid him the balance due, and the instrument was at the time delivered to her indorsed "Paid Nov. 11th, '92, C. C. Burr." On October 16, 1892, James E. Jones died, leaving a will, and Jacob Bigler was duly appointed executor of his estate, and qualified as such. The executor repudiates the payment made to Mr. Burr on November 11, claiming that the latter's authority to collect the note had been previously revoked by the death of Mr. Jones, and this action was brought to recover from Mrs. Muff the amount of said payment as the balance alleged to be due on the note. The jury returned a verdict for the defendant, under a peremptory instruction of the court so to do, and error has been prosecuted from the judgment entered thereon. After the filing of the record in this court Jacob Bigler died, and the action was revived in the name of Jasper C. Deweese, as executor *de bonis non* of the estate of James E. Jones, deceased.

It is disclosed that Mrs. Muff paid the amount due on the note to Burr in good faith, without any notice or knowledge whatsoever that he was not the owner of the paper, or that Mr. Jones, the payee, was dead. It is insisted that the court erred in directing a verdict for the defendant, because the death of Jones revoked the authority or power of Mr. Burr to receive from the maker payment of the obligation, although she was unaware of the death of the payee. Undoubtedly the rule is that the death of a principal instantly terminates the agency; but it by no means follows that all dealings with the agent thereafter are absolutely void. Where in good faith one deals with an agent within his apparent authority, in ignorance of the death of the principal, the heirs and representatives of the latter may be bound, in case the act to be done is not required to be performed in the name of the principal. There is a sharp conflict in the authorities on the question, but it is believed that the better reasoned cases sustain the proposition stated,

among which are the following: *Ish v. Crane,* 8 O. St. 520, 13 O. St. 574; *Cassidy v. M'Kenzie,* 4 Watts & Serg. (Pa.) 282; *Davis v. Lane,* 10 N. H. 156; *Dick v. Page,* 17 Mo. 234; *Moore v. Hall,* 48 Mich. 143; 1 Am. & Eng. Ency. Law (2d ed.) 1224.

We quote the following apposite language from the opinion in *Ish v. Crane,* 8 O. St. 520: "Now upon what principle does the obligation, imposed by the acts of the agent after his authority has terminated, really rest? It seems to me the true answer is, public policy. The great and practical purposes and interests of trade and commerce, and the imperious necessity of confidence in the social and commercial relations of men, require that an agency, when constituted, should continue to be duly accredited. To secure this confidence, and consequent facility and aid to the purposes and interests of commerce, it is admitted that an agency, in cases of actual revocation, is still to be regarded as continuing, in such cases as the present, toward third persons, until actual or implied notice of the revocation. And I admit that I can perceive no reason why the rule should be held differently in cases of revocation by mere operation of law. It seems to me that in all such cases the party who has, by his own conduct, purposely invited confidence and credit to be reposed in another as his agent, and has thereby induced another to deal with him in good faith, as such agent, neither such party nor his representatives ought to be permitted, in law, to gainsay the commission of credit and confidence so given to him by the principal. And I think the authorities go to that extent. (See *Pickard v. Sears,* 6 Ad. & Ell., Eng., 469.) The extensive relations of commerce are often remote as well as intimate. The application of this doctrine must include factors, foreign as well as domestic, commission merchants, consignees and supercargoes, and other agents remote from their principal; and who are required for long periods of time not unfrequently, by their principal, to transact business of immense importance, without a possibility of knowing perhaps even the probable continuance of the life of the principle. It must not unfrequently happen that valuable cargoes are sold and purchased in foreign countries by the agent, in obedience to his instructions from his principal, after and without knowledge of his death. And so, too, cases are constantly occurring of money being collected and paid by agents, under instructions of the principal, after and without knowledge of his death. In all these cases there is certainly every reason for holding as valid and binding the acts so done by the agency which the principal had, in his life, constituted and ordered, that there would be to hold valid the acts of one who

had ceased to be his agent, by revocation of his power, but without notice to the one trusting him as agent."

In the case at bar it was not necessary for the agent, Mr. Burr, to collect or receive the money in the name of Mr. Jones, nor did he do so. The defendant was justified in paying the money under the circumstances disclosed by the evidence. The note was properly indorsed by the payee in blank, and it was at the time in possession of Mr. Burr. Payment to him without knowledge that the note was held for collection, or that the owner was dead, discharged the debt. (*Davis v. Lusitanian Portuguese Benevolent Ass'n,* 20 La. Ann. 24;18 Am. & Eng. Ency. Law 190; *Edwards v. Parks,* 60 N. Car. 598; *Loomis v. Downs,* 26 Ill. App. 257; *Stoddard v. Burton,* 41 Ia. 582; *Boyd v. Corbitt,* 37 Mich. 52; *Johnson v. Hollensworth,* 48 Mich. 143.) In the case last cited a negotiable note was indorsed by the payee and delivered to an agent for collection. Subsequently the payee died. It was held that the authority to collect was not thereby revoked. A verdict for the defendant was properly directed in the case at bar. The conclusion reached obviates an examination of the instructions tendered by the plaintiff and refused by the court. The judgment is affirmed.

Ryan, C., not sitting.

§413 *PEARCE v. FOSTER.*

Court of Appeal, 1886. [17 *Q. B. Div.* 536.]

LORD ESHER, M. R.: We are all of opinion that this case is quite clear.

The rule of law is, that where a person has entered into the position of servant, if he does anything incompatible with the due or faithful discharge of his duty to his master, the latter has a right to dismiss him. The relation of master and servant implies necessarily that the servant shall be in a position to perform his duty duly and faithfully, and if by his own act he prevents himself from doing so, the master may dismiss him. It is not that the servant warrants that he will duly and faithfully perform his duty; because, if that were so, upon breach of his duty his master might bring an action against him on the warranty. But the question is, whether the breach of duty is a good ground for dismissal. I have never hitherto heard any doubt that that is the true proposition of law. What circumstances will put a servant into the position of not being able to perform in a due manner, his duties, or of not being able to perform his duty in a faithful manner, it is impossible to enumerate. Innumerable circumstances have actually occurred

which fall within that proposition, and innumerable other circumstances which never have yet occurred, will occur, which also will fall within the proposition. But if a servant is guilty of such a crime outside his service as to make it unsafe for a master to keep him in his employ, the servant may be dismissed by his master; and if the servant's conduct is so grossly immoral that all reasonable men would say that he cannot be trusted, the master may dismiss him.

The question is, whether we can differ from the learned judge who has determined the question of fact with reference to a confidential clerk to merchants, who, in the course of his duty, might have to advise his masters upon monetary matters, and who, in the course of his duty, might be called upon by his masters to have in his hands securities of great value, but who is found during the service, secretly from his masters, to have been engaged not in one or two small transactions, but in enormously large gambling transactions on the Stock Exchange in differences, so that he might at any time be landed in immense losses; and whether we can say that the learned judge is wrong in holding that a man who has done that whilst he was a servant, has done that which is incompatible with a safe performance of his duty to his masters; and if the learned judge has held that such a clerk, by such a course of conduct to such an extent has brought himself into a position that the masters cannot fairly rely upon his faithfulness—because the clerk has palpably left himself open to temptation, so great that it is beyond safety to the masters and to the masters' business—the question is whether we can say that the learned judge is wrong, or that a jury would be wrong, in finding that that is incompatible with the safe performance of his duty to his master. Wherever a clerk in a mercantile service, or in a service of trust, breaks any of the rules of good conduct, and wherever a jury finds that the master was justified in dismissing him, I should like it to be known by all persons in that position that this Court will uphold the decision, and I think that every judge and every jury, if such conduct is brought before them as has been imputed to and proved against the plaintiff in this case, holding the position which he did in the office of merchants, would come to the conclusion that gambling to a large extent on the Stock Exchange in differences is wholly incompatible with the due and faithful performance of his duties, if he does so unknown to his master. I should like to say in plain terms, so that it may be understood, that the moment it is made known to a master that his clerk has been gambling to anything like this extent on the Stock Exchange, that of itself will

authorize any tribunal in saying that the master was justified in dismissing the servant.

I think that the judgment of the learned judge was beyond all doubt and question perfectly right.

§414 *PETERSON v. DREW.*

District Court of United States for Division No. 1 *of Alaska Territory,* 1905. [2 *Alaska* 560.]

GUNNISON, District Judge. The plaintiff sues on two counts under contract for services, which is as follows:

> "This agreement, made and entered into at Juneau, Alaska, this 22d day of July, 1903, by and between Thomas D. Drew, of the one part, and John G. Peterson, of the other part, witnesseth:
>
> "Whereas Thomas D. Drew has this day purchased of and from said John G. Peters the following named lode mining claims (here follows description of mining claims), and is desirous of securing the services of the said John G. Peterson for the period of one year from date hereof in and about said mining claims premises in the working and developing of the same.
>
> "Therefore, it is hereby agreed by and between the parties hereto that the said John G. Peterson shall and will enter into the employ and service of the said Thomas D. Drew for one year from the date hereof, and perform such work and services required of him in and about said mining claims in the working, mining, and developing of the same.
>
> "In consideration of the foregoing promise and agreement on the part of the said Peterson, the said Drew hereby agrees and promises to pay the said John G. Peterson for such services, to be rendered as aforesaid, a monthly compensation or wages of $150 for each and every month during the life of this agreement."

Under this agreement plaintiff entered the employ of the defendant on the 22d day of July, 1903, though he did not actually begin work on the premises until the 10th day of August following. He continued to perform the services as per agreement until the 20th day of April, 1904. Prior to that time, however, and on the 20th day of January, 1904, the defendant became dissatisfied with the manner in which the plaintiff was performing those duties, and informed plaintiff that he no longer required his services. Plaintiff, however, continued to

carry out his part of the contract, and defendant accepted such service until the 20th day of April, 1904, when defendant finally definitely dismissed plaintiff. During the greater portion of this time plaintiff acted as defendant's superintendent on the mining claims, buying supplies for the camp, and paying the workmen from a fund on deposit in the B. M. Behrends Bank at Juneau, which was subject to his check. As such superintendent he kept the time of the workmen employed upon the claim. During this time he lived at the messhouse with the other miners, all of whom paid or were charged $1 per day or $30 per month for their board, and this was deducted from their wages. Plaintiff, however, did not deduct this amount from his wages, but collected the whole amount whenever paid. It also appears from the evidence that in keeping the time of and paying the men at the works plaintiff overpaid them to the amount of $152.45.

Plaintiff sues upon two counts—one for wages earned and unpaid, and the other, under the terms of the agreement, for wages from April 20, 1904, to July 22, 1904, the period for which the contract was to run after the plaintiff had been discharged from the service of the defendant. Under the contract it is plain that the plaintiff's compensation began to run from the date thereof, regardless of when he actually went upon the mining claims, inasmuch as the contract provides that plaintiff was "to enter into the employ and service of the said Drew for the period of one year from the date" of the contract, and his compensation was to be "$150 for each and every month during the life of this agreement." The fact that the defendant attempted to discharge the plaintiff on the 10th of January, but that plaintiff continued to perform the duties under the contract until the 20th day of April thereafter, without any further remonstrance on the part of the defendant until he did actually discharge him on the latter date, does not relieve the defendant from the liability under the contract, he having accepted such service and such benefit as might accrue therefrom. Therefore the plaintiff should recover at the rate of $150 per month from the 22nd day of July, 1903, to the 20th day of April, 1904. So long as he rendered the service to defendant that he had agreed to render under the contract, and defendant, even though he had told him to quit, did not enforce his direction, and was receiving the benefit of the service, he should be paid therefor.

Plaintiff on the second count seeks to recover wages for the balance of the life of the contract at the stipulated price. The first question to be determined is whether or not plaintiff

is wrongfully discharged. From the evidence adduced on the trial, there is no doubt but that defendant had cause, and good cause, for discharging the plaintiff, and the court so finds.

This being the fact, it becomes necessary to inquire as to what are plaintiff's rights in the premises. Even had the plaintiff been wrongfully discharged, he could recover nothing for the balance of the term under the theory of constructive service, upon which his second cause of action is based; for while there are some cases, English and American, that uphold that theory, the weight of authority and sound reasoning is against the constructive service. This is discussed in the case of *Howard v. Daly,* 61 N. Y. 362, 373, 19 Am. Rep. 285, as follows:

> "This doctrine is so opposed to principle, so clearly hostile to the great mass of authority, and so wholly irreconcilable to that great and beneficent rule of law that a person discharged from service must not remain idle, but must accept employment elsewhere if offered, that we cannot accept it. If a person discharged from service may recover wages or keep the contract as still subsisting, then he must remain idle in order to be always ready to perform the service. How absurd it would be that one rule of law should call upon him to accept other employment, while another rule of law required him to remain idle in order that he may recover full wages. The doctrine of constructive service is not only at war with principle, but with the rules of political economy, as it encourages idleness, and gives compensation to men who fold their arms and decline service equal to those who perform with willing hands their stipulated amount of labor. Though the master has committed a wrong, the servant is not for one moment released from the rule that he should labor, and no rule can be sound which gives him full wages while living in voluntary ease."

The evidence discloses that not only did plaintiff not enter other employ, but that he made no effort to seek other employment, as he was in duty bound to do on his theory of the case. 20 Am. & Eng. Ency. of Law, p. 34, and cases there cited.

Upon that theory of the case, had he been wrongfully discharged, he could not have recovered full compensation, as he seeks to herein, because of his failure to exercise reasonable diligence in seeking other employment, and thus reducing, or

attempting to reduce, the damages or loss to himself resulting from the wrongful discharge.

But where the contract of service or hiring is broken as the result of the servant's own inefficiency, carelessness, and neglect of, and inattention to, his duties under the contract, as in the case at bar, the servant may not hope to recover anything upon the contract after its breach, because he alone is responsible therefor.

Let findings of fact and conclusions of law be prepared in conformity herewith.

§415 *JOHNSON v. WALKER*

Supreme Judicial Court of Massachusetts, 1892. [155 *Mass.* 253.]

CONTRACT to recover the balance due upon an agreement to work for the defendants for a year. Trial in the Superior Court, before LATHROP, J. The plaintiff introduced evidence tending to prove the following facts:

The defendants on December 1, 1886, hired the plaintiff to be the foreman of the gang-room in their shoe shop at Brockton, for the term of one year, at a salary of twenty-four dollars a week. The plaintiff was to have charge of a number of men employed in such room, to superintend them and see that they were kept employed, to lay out their work and to see that it was properly done; and the presence of some one acting either temporarily or permanently as such foreman was necessary for the successful carrying on of the defendants' business.

The plaintiff entered on his employment under the contract, and worked for the defendants, and received his pay weekly according to the terms of the contract, until September 8, 1887. On that day he became ill with typhoid fever, and so remained until October 25 following, during which period he was incapacitated for work in the shop, and did not go there, and sent no notice to the defendants of the reason of his absence, of his condition, or in regard to the time he would be likely to remain absent or be able to resume work, except that on the day he was taken ill he informed them that he was ill, and went home. At no time during his illness was the plaintiff dangerously ill, or in danger of death, or of being permanently incapacitated for his work. On October 25 the plaintiff became well, and reported at the shop to go to work in pursuance of his contract. He was then and there told by the defendants that he had been discharged, and that there was a man in his place. This was the first knowledge the plaintiff had of his discharge. There was no evidence that the defendants made

any inquiries regarding the illness or condition of the plaintiff during his absence, or gave him any reason for discharging him; nor was there any evidence as to when the discharge was made, or that the plaintiff was notified thereof until October 25.

The action was for the balance due for the term of one year, from September 8, 1887, to December 1, 1887, waiving any claim for salary during the period of the plaintiff's illness.

The defendants asked the judge to rule, as matter of law upon the evidence, that the plaintiff could not recover. The judge so ruled, and ordered a verdict for the defendants, and the plaintiff alleged exceptions.

MORTON, J.: If the contract was an absolute one, the plaintiff is entitled to recover. There were no qualifications annexed to it in terms. But we think, as matter of law, it must be deemed to have been a qualified and conditional contract. It related to the personal services of the plaintiff. These could be performed by no one except him. The work to which they related could be done by another, but his own services could be rendered by no one except himself. They could be rendered by him only so long as he was of sufficient health and capacity. We think, therefore, that it was implied that inability from sickness or disease to perform the services on which the contract depended would be a sufficient excuse for non-performance on his part and on that of the defendants. *Yerrington v. Greene,* 7 R. I. 589. *Cuckson v. Stones,* 1 El. & El. 248, 257. *Spalding v. Rosa,* 71 N. Y. 40. *Robinson v. Davidson,* L. R. 6 Ex. 269. *Boast v. Firth,* L. R. 4 C. P. 1 *Hubbard v. Beldon,* 27 Vt. 645. *Ryan v. Dayton,* 25 Conn. 188. *Green v. Gilbert,* 21 Wis. 395.

Whether a temporary illness of a few hours, or in some instances perhaps of a few days, would in all cases come within the implied condition, we need not consider. In the present case the plaintiff was sick about seven weeks, and during all that time, as the exceptions state, was incapacitated from work in the defendant's shop. We think that, as a matter of law, this constituted such an interruption of and failure to perform his contract on the part of the plaintiff, that the defendants were justified in terminating it, and employing another person in his place.

If the defendants had not paid the plaintiff all that was due him at the time when he was taken ill, his illness would have operated as an excuse, so that, notwithstanding the non-performance of his contract, he could have maintained an action against them for the amount due him. *Fuller v. Brown,* 11

Met. 440. *Harrington v. Fall River Iron Works,* 119 Mass. 82. But the fact that he was incapacitated by causes beyond his own control, or, as it is termed, by the act of God, did not deprive the defendants of their right to terminate the contract, or oblige them to keep his position for him till he recovered. The right of the defendants to terminate the contract did not depend on giving notice to the plaintiff, but on the fact that he had become unable to render the services on whose continuance the contract depended.

Without undertaking to say that in no case could there be a duty on one side or the other to give notice of an intention to dissolve the contract because of inability to perform it on account of illness, we think there was no such duty on the defendants in the present case.

Exceptions overruled.

§416 *MYRA A. BLODGETT'S ESTATE v. JULIUS CONVERSE'S ESTATE. ADELINE EDSON'S ESTATE v. SAME. MELISSA A. CONVERSE'S ESTATE v. SAME.*

Supreme Court of Vermont, 1888. [60 *Vt.* 410.]

Appeal from the Probate Court.

The appellant filed the general counts in *assumpsit.*

Heard on the report of a refereè, December Term, 1887, TYLER, J., presiding. Judgment *pro forma* in the Blodgett case to recover the sum of $455.83; in the Edson case, the sum of $6,406.45; and in the Converse case the sum of $629.89. Exceptions by the plaintiffs. The facts are sufficiently stated in the opinions of the court.

The opinion of the court was delivered by

ROSS, J.: These cases were referred to the same referee, and stand for consideration on his reports which are dependent more or less upon his report in the principal case. The only contention upon all the reports is when and under what circumstances will the defendant estate be liable for interest. The persons whose estates are plaintiffs in interest were sisters, and the last named was the former wife of the late ex-Governor Converse. He seems to have been the financial agent of the three for a good many years. He settled the estate of their father. He also settled the estate of Mr. Edson. Although some questions arose before the referee in regard to his relations to these two estates, none is pressed before this court. Mr. Converse acted for the three sisters in settlement of their brother Gardner Arnold's estate. The three received in all

over twenty thousand dollars from this estate. Mr. Converse was the agent and attorney of the three, and as such received all the money from the executor of Gardner Arnold's will. He deposited the money thus received in his own name in connection with his own deposits in two banks. Most of it was received in 1868 and 1869, but some in 1872. He credited the three with the money as received, and as he paid out to, or invested it for, each, charged the general account with the payments and investments, and charged each sister with the payments or investments made for her. His bank accounts, which are referred to by the referee, show that within less than a year after he made deposits of money and funds received from Gardner Arnold's estate, he had drawn it all out and used it in some way. The investments for the earlier part of the time were for his wife and Mrs. Edson. He made some payments to Mrs. Blodgett, but no investments for her, but turned over some to her in 1875. She had a large balance in his hands all these years, on which the referee has allowed her estate no interest. After he had once withdrawn it from the bank, his accounts do not show that he replaced the amount so drawn out. The accounts show that he did not keep the money belonging to Mrs. Blodgett on deposit for her. Her estate claims interest on the amount he had in his hands, deposited in his general bank account in his own name, or at least interest on it after the accounts show that he withdrew and used the money. Mrs. Converse died in December, 1872. She made a will, and Mrs. Edson was the executrix named in it. She died in January, 1873, and the will was not proved until 1875. Mr. Converse had her estate in his hands all this time and did not pay it over entirely during his life. He deceased in 1885. He also had Mrs. Edson's property in his hands when she died and did not fully settle with those entitled to her estate during his life. He was called upon to settle with all these estates in 1875, and frequently after, and expressed a willingness to settle, but it was never accomplished. In his account with his wife's estate, he made several charges to it of investments, and afterwards—but when was not shown—wrote against such charges "taken back." He had interest-bearing debts belonging to both the estate of his wife and of Mrs. Edson. The referee has allowed interest on these, only so far as shown by his account that he received it, or his receipt was otherwise proved. The referee allowed no interest on the investments charged, and afterwards entered "taken back." In 1881 suits were brought against Mr. Converse in favor of these estates, and in favor of Mrs. Blodgett, who subsequently deceased. These suits were abated by

the death of Gov. Converse. The referee has charged his estate with interest in favor of the three estates only when his books showed he received interest or it was otherwise shown, until the suits were brought, and has allowed interest on the balance found due each estate at the time the suits were commenced. It is claimed for the estates, in addition to what has already been stated for Mrs. Blodgett's estate, that the call for a settlement in 1875 was equivalent to a demand for payment, and that all three estates should be allowed interest on whatever was in his hands at that date, or at least that he should account for interest on all that was then in his hands from that date, or show some valid reason why he should not pay it. It is further contended that when interest-bearing debts and securities are once shown to belong to an estate or to have been charged to an estate by him, he could not take them back to his own use, without securing to the estate the interest it would have received from the investment—at least without showing good reason for taking the investment back—and that where interest-bearing investments are once shown into his hands, it is to be presumed he received the interest thereon; that it was his duty to show why he did not receive the interest as it became due from time to time, if he did not, and that without such showing his estate should be charged with all the interest that was legally due on such investments. While these claims do not all apply to all the cases, all arise in the cases. We are not so much troubled to ascertain the rules of law applicable, in general, to these several claims made in behalf of the plaintiff estates, as we are to apply them justly and fairly to the facts of these cases. Gov. Converse was evidently the trusted, confidential financial agent of these three women. Their relations were very intimate and friendly. His charges after he had received the money from Gardner Arnold's estate for its care were small. It almost looks as though they intended he should make some profit from the use of their money unaccounted for. But this is not found by the referee, nor any facts from which an inference can be legally drawn. Not a settlement with any of them is shown by his books, unless it was with his wife. The immediate parties are all deceased. No one is left to tell us how they regarded these financial dealings, or what understandings they had in relation to them. Under such circumstances we know of no guide, except the well-established rules of the law. These must be applied to the facts as they have left them.

I. In regard to the money received from Gardner Arnold's estate for Mrs. Blodgett, which was deposited in his general bank account and drawn out and used, we think the law is well

settled that Mr. Converse was chargeable for interest from the time he used it. He received this money as her agent or attorney. In *Miller v. Clark,* 5 Lansing, N. Y. R. 390, it is said: "If an agent mixes the money of his principal with his own, and makes use of it, he is liable to pay interest on it from that time, or if he uses it separately, and makes a profit upon it, or puts it to interest while in his hands, the principal is entitled to such profit or interest."

"But as a general proposition, an agent is not liable to be charged with interest upon moneys received, and held by him for the use of the principal. In order to render him liable for interest some other fact must be shown in addition to the mere receiving and retaining the money in his hands." Dunlap's Paley on *Agency,* 49, 50; *Williams v. Storrs,* 6 Johns. Ch. 353.

In *Lewis v. Bradford,* 8 Ala. N. S. 632, it is said: "Where one has the money of another in his hands and uses it, he cannot avoid the payment of interest, by answering that he does not know what profit was made by its use. In such a case he is, at least, liable for interest while it was so employed." We think this a clear and just statement of the law upon the subject.

To the same effect is *Hinckley, Recr. v. Gilman, C. & S. R. R. Co.,* 100 U. S. 153, Bk. 25 L. Ed. 591; Wharton's *Agency and Agents,* s. 243. Mr. Wharton says: "An agent who mixes his principal's property with his own is liable for interest; and the burden of proof will be on him to distinguish the two masses. If he fail to do this, the aggregate may be charged to him as the principal's." He cites a large number of cases in support of this doctrine. The last sentence of the quotation implies that the agent derives a benefit from the use of the property. We should not be prepared to say that the agent or attorney who deposits his principal's or client's money to his own credit, in his general bank account, would thereby make himself liable for interest. But we think, when he has so mixed his principal's money with his own, and has used it by making drafts upon it for his own use, the law presumes he gains a benefit from such use; that he is thereupon called upon to show what benefit he has derived from such use, and on his failing to show the benefit derived, will be charged with interest upon it. *Hauxhurst v. Hovey,* 26 Vt. 544, is not opposed to these views. That case holds that an agent or attorney who collects and retains the money of his principal will not be chargeable with interest unless he has orders to remit as fast as collected, or the money has been demanded, or some other fact is shown to place him in legal default. The referee's

report does not show the amount of interest Mrs. Blodgett's estate would be entitled to on this holding. The case will be sent to the clerk to have this computation made, and for other purposes hereafter indicated.

II. We do not think a request to settle with an expressed willingness on the part of Mr. Converse, but a neglect to do so, because neither party was quite ready to take up the matter, equivalent to a demand to pay over what was in Mr. Converse's hands. From all that is found, the reason the settlement was not made might have been quite as much the fault of the plaintiffs as of the defendant. The facts reported do not bring the case within the cases relied upon for the plaintiffs. In *Hall & Chase v. Peck & Co.,* 10 Vt. 474, a demand for payment after the writ was dated, but before it was served, was held sufficient to authorize the commencement of the suit, and if the commencement of the suit, the commencement of interest, as damages. But in this case, with what accompanied it, the request for settlement cannot be held equivalent to a demand for payment. In *Gleason v. Briggs,* 28 Vt. 135, an attempt at settlement, in which each party denied the claims of the other, was held, a little doubtfully, to be a demand for payment by both parties. Says Judge REDFIELD, "They met and attempted to settle, which was fairly enough, perhaps, regarded as a demand or claim of payment upon both sides for what should happen to be due." This was said in upholding the action of the auditors in casting interest for both parties, as of that date. But as is said in *Hauxhurst v. Hovey, supra,* to authorize the allowance of interest against an agent or attorney, there should be something shown to make it appear "that the party is legally in default." This does not appear from the facts reported, when all are considered. This contention for the plaintiffs is not sustained.

III. We think, from the principles already stated, it follows that where an agent or attorney has interest-bearing securities in his hands belonging to his principal, the law presumes that he receives the interest thereon and the principal, and that the burden is cast upon the agent to show that he has not received the interest as it became due, nor the principal. By shoving such investments into the agent's hands, he is made accountable therefore. He cannot escape liability by silence, nor by saying: "I don't know what I received thereon." Nor does the failure of his account to show the receipt of interest remove his accountability therefore. The entries there made are made by himself, and his failure to make any entry does not account for what has been

shown into his hands, nor for interest, which he should, and the law presumes he does, receive on interest-bearing securities. In short, an agent receiving money is to account for it as money without interest, unless he is shown to be legally in default in regard to its payment, and receiving interest-bearing securities, is to account for the principal and interest without further showing; and his failure to account for either is not an accounting; nor when he has once charged himself with interest-bearing securities, is the writing against such charge at some indefinite time in the future, "taken back," such an accounting. The moment the principal's funds were invested in such securities, they became the property of the principal, and the principal was entitled to the avails of such investments, principal and interest. The agent or attorney could not divert such investments to his own use, without liability for interest on the investments so diverted. By taking such investments, once vested in the principal, to his own use, without something further shown, the agent converts them to his own use, and should be charged with interest on their value, at least, until he replaces them with other interest-bearing securities. We do not mean to say the agent could not be allowed to explain such action in a manner that would relieve him from payment or allowance of interest, but that without explanation, he is chargeable with interest.

IV. The plaintiff contends that Mr. Converse is to be treated as an executor *de son tort* of his wife's estate, and that this would render him liable as for the conversion of the estate. But if under our system of settling estates this common law doctrine is applicable, of which there may be a doubt, *Shaw, administrator, v. Hallihan,* 46 Vt. 389,—we do not think it applies to Mr. Converse in this case. His wife died testate. The executrix died within less than a month thereafter. No steps were taken for some time to have the will proved. He is not found to have been in fault for the delay. In the meantime he had the estate in his hands. It needed caring for. We think that he should be held to exercise the care of a faithful agent or attorney for whomsoever should thereafter be appointed administrator with the will annexed. This contention of the plaintiff is not sustained.

The referee has not stated, with sufficient particularity, the facts and dates to enable this court to ascertain the exact sums for which judgments should be rendered in each of these cases. But the holdings on points one and three reverses the judgment of the County Court in the three cases and the matter is referred to the clerk to make on notice the necessary computa-

tions of interest upon the facts found by the referee, in accordance with the views herein expressed, and judgment is rendered for each plaintiff for the sum so ascertained with costs, and the costs of the suit abated by the death of Mr. Converse;—the judgments to be certified to the Probate Court.

B. In Partnership.

§417 *KARRICK v. HANNAMAN.*

United States Supreme Court, 1897. [168 U. S. 328.]

This was a suit brought April 17, 1890, in the third judicial district court of the Territory of Utah, by Hannaman against Karrick for the dissolution of a partnership, formed February 3, 1886, by an agreement in writing, by which they agreed to become partners in a mercantile and laundry business for the term of five years from that date, with a capital stock of $25,000, of which the plaintiff was to furnish $5,000, and the defendant $20,000; the defendant lent the plaintiff the sum of $5,000 for five years, for which the plaintiff gave a promissory note, payable at the end of that time, and secured by mortgage upon his interest in the partnership property; the plaintiff was to give his entire time and attention to the partnership business, and the defendant was to devote to it only such time as he should see fit; the plaintiff to have the control and management of the business generally and entirely, except as the defendant might designate, and such matters to be subject to mutual agreement; one-half of the net profits of the business to go to the defendant in repayment of $15,000 of the capital stock furnished by him, and the other half to be allowed to remain in the business, except that each partner might draw out not exceeding $125 a month for personal expenses; the profits and losses to be shared equally, and neither party to have any other salary or compensation for services; and the title and interest of the partners in the partnership property to be proportionate to their respective contributions to the capital.

The complaint alleged the following facts: The parties carried on business in conformity with the agreement until February 1, 1888, when the defendant took exclusive possession of all partnership business, stock, books and accounts, and of the premises where the business was carried on, and ever afterwards prevented the plaintiff from participating in any manner in the business or deriving any benefits therefrom. The plaintiff until that date performed his part of the agreement, and was ever after ready and willing to perform it, and so informed the defendant. From that date, the defendant wrongfully, and

in fraud of the plaintiff's rights, carried on and controlled the partnership business for his own exclusive benefit, and applied to his own use from the proceeds and profits of the same large sums of money, exceeding the proportion to which he was entitled. On January 1, 1890, the defendant, without the plaintiff's knowledge or assent, sold and delivered to the Bast-Marshall Mercantile Company all the assets and property of the partnership. The complaint prayed for a dissolution of the partnership, the appointment of a receiver, an injunction against interfering with the property, its application to the payment of the partnership debts and a division of the remainder between the partners, the setting aside and cancellation of any transfer or assignment to the Bast-Marshall Mercantile Company, and an account.

The defendant Karrick, in his answer, admitted the partnership, and his own taking possession on February 1, 1888; but denied the other allegations of the complaint; and alleged that the plaintiff mismanaged the business in various particulars specified, and that when the defendant took possession the partnership was insolvent and heavily in debt, and the plaintiff was owing to it a large sum of money, and was insolvent, and the partnership was then dissolved by mutual consent.

The Bast-Marshall Mercantile Company was originally made a defendant, and filed a separate answer. But the plaintiff afterwards dismissed his suit as against that company; the case was referred by consent of the remaining parties to a referee to report his findings of fact and conclusions of law to the court; and at the hearing before the referee much evidence was introduced by either party in support of his allegations and denials.

On October 5, 1891, the referee made his report, in which he set forth all the evidence; and by which he found that the facts were as alleged in the complaint, and were not as alleged in the answer of Karrick; and stated an account, resulting as follows:

Unadjusted and undivided profits January 1, 1890, including $2,616.25 then uncollected by defendant	$22,858.18
Profits realized after January 1, 1890	99.90
Wrongfully disbursed by defendant after that date	379.50
	$23,337.58
Unavoidable losses after January 1, 1890	2,005.12
Net profits	21,332.46

Of which plaintiff is entitled to one-half....	10,666.23
Capital put by plaintiff into the business....	5,208.89
	15,875.12
Due from plaintiff to defendant on note mentioned in partnership agreement, without interest	5,0000.00
Principal sum due to plaintiff	10,875.12
Interest at eight per cent. yearly from January 1, 1890, to October 5, 1891, on $8,-258.87, the difference between $10,875.12 and $2,616.25 uncollected January 1, 1890	1,165.41
Total amount due to plaintiff	$12,040.53

From the findings of fact the referee concluded, as matter of law, that the partnership was not dissolved; but that it expired February 3, 1891, according to the terms of the agreement; that the profits and losses of the partnership business should be divided equally between the parties, after crediting each with his advances to and investments in the partnership; and that the sum of $12,040.53 was therefore owing to the plaintiff. The court confirmed the referee's findings of fact and conclusions of law, and entered a decree accordingly.

The defendant appealed to the Supreme Court of the Territory, which adopted the findings of fact in the district court, and held that, for the reasons stated in its opinion, the defendant could not dissolve the partnership without reasonable cause, and without the plaintiff's consent, before the expiration of the term stipulated in the partnership articles; and therefore that the partnership had not been dissolved by the acts of the defendant; but that, as each partner was permitted by those articles to draw out of the partnership $125 a month for personal expenses, the defendant should have been allowed the sum of $3,000 as personal expenses for the two years during which he conducted the business of the firm; and that the judgment should be modified by deducting one-half of this sum, and, so modified, be affirmed for the sum of $10,540.53. 9 Utah, 236. The defendant appealed to this court.

Mr. Justice Gray, after stating the case, delivered the opinion of the court.

Much of the argument for the appellant was devoted to a discussion of conflicting evidence, which is not open to examination by this court, its authority upon appeal from the Supreme Court of a Territory being limited to the question whether the

facts found by that court support its judgment. *Haws v. Victoria Co.,* 160 U. S. 303; *Harrison v. Perea,* 162 U. S. 311.

The principal question of law discussed in the opinion of the Supreme Court of the Territory, and at the argument in this court, was whether a partnership, which by the co-partnership articles is to continue for a specified time, can be dissolved by one partner at his own will without the assent of the other before the expiration of that time.

It is universally conceded that a contract of partnership, containing no stipulation as to the time during which it shall continue in force, does not endure for the life of the partners, or of either of them, nor for any longer time than their mutual consent, but may be dissolved by either partner at his own will at any time. *Peacock v. Peacock,* 16 Ves. 49; *Crawshay v. Maule,* 1 Swanst. 495; *Neilson v. Mossend Iron Co.,* 11 App. Cas. 298; 3 Kent *Com.* 53; *Story on Partnership,* §269.

Upon the question how far the status or relation of a partnership which by the partnership agreement is to continue for a certain number of years, can be determined by one partner without the consent of the other before the expiration of that time, there has been some difference of opinion.

The principal reasons and authorities in favor of the position that a contract of partnership for a definite time cannot be dissolved at the mere will of one partner are stated or referred to in the opinion of the Supreme Court of the Territory in this case, reported in 9 Utah, 236.

Those which support the opposite view may be summed up as follows: A contract of partnership is one by which two or more persons agree to carry on a business for their common benefit, each contributing property or services, and having a community of interest in the profits. It is in effect a contract of mutual agency, each partner acting as a principal in his own behalf and as agent for his co-partner. *Meehan v. Valentine,* 145 U. S. 611. Every partnership creates a personal relation between the partners, rests upon their mutual consent, and exists between them only. Without their agreement or approval, no third person can become a member of the partnership, either by act of a single partner, or by operation of law; and the death or bankruptcy of a partner dissolves the partnership. 3 Kent *Com.* 25, 55, 58; *Wilkins v. Davis,* 2 Lowell, 511. So an absolute assignment by one partner of all his interest in the partnership to a stranger dissolves the partnership, although it does not make the assignee a tenant in common with the other partners in the partnership property. *Bank v. Carrolton Railroad,* 11 Wall. 624, 628; *Marquand v. New York Manuf. Co.,*

17 Johns. 525, 528, 535. No partnership can efficiently or beneficially carry on its business without the mutual confidence and co-operation of all the partners. Even when, by the partnership articles, they have covenanted with each other that the partnership shall continue for a certain period, the partnership may be dissolved at any time, at the will of any partner, so far as to put an end to the partnership relation and to the authority of each partner to act for all; but rendering the partner who breaks his covenant liable to an action at law for damages, as in other cases of breaches of contract. *Skinner v. Dayton,* 19 Johns. 513, 538; 3 Kent *Com.* 54, 55, 62; *Cape Sable Co.'s Case,* 3 Bland, Ch., 606, 674; *Monroe v. Conner,* 15 Maine, 178, 180; *Mason v. Connell,* 1 Whart. 381, 388; *Slemmer's Appeal,* 58 Penn. St. 168, 176; *Blake v. Dorgan,* 1 Greene (Iowa), 537, 540; *Solomon v. Kirkwood,* 55 Mich. 256, 259, 260. According to the authorities just cited, the only difference, so far as concerns the right of dissolution by one partner, between a partnership for an indefinite period and one for a specified term, is this: In the former case, the dissolution is no breach of the partnership agreement, and affords the other partner no ground of a complaint. In the latter case, such a dissolution before the expiration of the time stipulated is a breach of the agreement, and as such to be compensated in damages. But in either case the action of one partner does actually dissolve the partnership.

A court of equity, doubtless, will not assist the partner breaking his contract to procure a dissolution of the partnership, because, upon familiar principles, a partner who has not fully and fairly performed the partnership agreement on his part has no standing in a court of equity to enforce any rights under the agreement. *Marble Co. v. Ripley,* 10 Wall. 339, 358. But, generally speaking, neither will it interfere at the suit of the other partner to prevent the dissolution, because, while it may compel the execution of articles of partnership so as to put the parties in the same position as if the articles had been executed as agreed, it will seldom, if ever, specifically compel subsequent performance of the contract by either party, the contract of partnership being of an essentially personal character. Batten on *Specific Performance,* 165-167; Lindley on *Partnership,* bk. 3, c. 10, §4; Pomeroy on *Specific Performance,* §290; *Scott v. Rayment,* L. R. 7 Eq. 112.

Even if the partnership should be considered as having been actually dissolved at that date, yet the dissolution did not put an end to the plaintiff's right to his share in the property and the profits of the partnership. . . .

A partner who assumes to dissolve the partnership, before the end of the term agreed on in the partnership articles, is liable, in an action at law against him by his co-partner for the breach of the agreement, to respond in damages for the value of the profits which the plaintiff would otherwise have received. *Bagley v. Smith,* 10 N. Y. 489; *Dennis v. Maxfield,* 10 Allen, 138. In a court of equity, a partner who, after a dissolution of the partnership, carries on the business with the partnership property, is liable, at the election of the other partner or his representative, to account for the profits thereof, subject to proper allowances. *Ambler v. Whipple,* and *Pearce v. Ham,* above cited; *Hartman v. Woehr,* 3 C. E. Green (18 N. J. Eq.), 383; *Freeman v. Freeman,* 136 Mass. 260; *Holmes v. Gilman,* 138 N. Y. 369; 3 Kent. *Com.* 64. . . .

It does not appear to have been suggested by the defendant in either of the courts of the Territory, and could not successfully be contended, that in estimating the damages or the profits which the plaintiff was entitled to recover, any deduction should be made by reason of his not having performed during those two years the services, as manager of the business, which he had agreed by the partnership articles to perform. No finding as to the value of such services was made or requested; and the defendant himself not only refused to let the plaintiff, as he offered to do, perform them during those two years, but, in his answer and at the hearing before the referee, insisted that the plaintiff's services as manager were of no benefit to the partnership.

The result is that, whether the partnership should or should not be considered to have been dissolved when the defendant ousted the plaintiff and assumed the exclusive possession and control of the property and business of the partnership, the defendant has shown no ground for reversing or modifying the final decree of the Supreme Court of the Territory.

Decree affirmed.

§418 *GILLETT v. HIGGINS.*

Supreme Court of Alabama, 1905. [142 *Ala.* 444.]

HARALSON, J.: The action taken by the defendants in excluding the complainant from the business of his firm, as set up in the bill, presented a sufficient cause for the dissolution of the partnership by the court of equity on the application of the complainant. *Moore v. Price,* 116 Ala. 247; *Meaher v. Cox,* 37 Ala. 201; 17 Am. & Eng. Ency. Law (1st Ed.), 1106-7.

While the taking into the custody of the court the partner-

ship effects [*sic*] was a stringent measure, not to be resorted to except remedially, yet it rests largely within the discretion of the court; and the authorities affirm, as a general rule, "that when a bill is filed seeking a dissolution of a partnership, and it satisfactorily appears that the complainant will be entitled to a decree for dissolution, a receiver will be appointed of course." *Bard v. Bingham,* 54 Ala. 463; *Briarfield Iron Works v. Foster, Ib.* 622; *Bank v. U. S. S. & L. Association,* 104 Ala. 297.

The steps taken by complainant's partner, Gillett, in selling out the firm's goods and turning over the business to strangers in the manner averred were radical and extraordinary, and in utter disregard of complainant's rights and interests, making a *prima facie* case for the appointment of a receiver, even without notice of the application. *Hendrix v. A. F. L. M. Co.,* 95 Ala. 316; *Ashurst v. Lehman Durr & Company,* 86 Ala. 370. Here the matter of the appointment of the receiver was brought forward by supplemental bill, the receiver was appointed on the 8th of September, and qualified by executing the bond prescribed on the 9th, and a motion was made to discharge him on the 12th, which was set for hearing on the 15th of September and overruled.

We have not been shown nor have we ascertained wherein the court erred in the appointment of the receiver.

No appeal lies from the refusal of the court to vacate an order appointing a receiver, such an order being merely interlocutory. *Miller v. Lehman, Durr & Co.,* 87 Ala. 519.

Affirmed.

McCLELLAN, C. J., DOWDELL and DENSON, J. J., concurring.

§419. *Uniform Partnership Act.*—Section 29. (Dissolution Defined.) The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.

Sec. 30. (Partnership not Terminated by Dissolution.) On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.

Sec. 31. (Causes of Dissolution.) Dissolution is caused:

(1) Without violation of the agreement between the partners,

(a) By the termination of the definite term or particular undertaking specified in the agreement,

(b) By the express will of any partner when no definite term or particular undertaking is specified,

(c) By the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking,

(d) By the expulsion of any partner from the business *bona fide* in accordance with such a power conferred by the agreement between the partners;

(2) In contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this section, by the express will of any partner at any time;

(3) By any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership;

(4) By the death of any partner;

(5) By the bankruptcy of any partner or the partnership;

(6) By decree of court under section 32.

Sec. 32. (Dissolution by Decree of Court.) (1) On application by or for a partner the court shall decree a dissolution whenever:

(a) A partner has been declared a lunatic in any judicial proceeding or is shown to be of unsound mind,

(b) A partner becomes in any other way incapable of performing his part of the partnership contract,

(c) A partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business,

(d) A partner wilfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him,

(e) The business of the partnership can only be carried on at a loss,

(f) Other circumstances render a dissolution equitable;

(2) On the application of the purchaser of a partner's interest under sections 27 and 28:

(a) After the termination of the specified term or particular undertaking,

(b) At any time if the partnership was a partnership at will when the interest was assigned or when the charging order was issued.

Sec. 38. (Rights of Partners to Application of Partnership Property.) (1) When dissolution is caused in any way, except in contravention of the partnership agreement, each partner, as against his co-partners and all persons claiming

through them in respect of their interests in the partnership, unless otherwise agreed, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners. But if dissolution is caused by expulsion of a partner, *bona fide* under the partnership agreement, and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under section 36 (2), he shall receive in cash only the net amount due him from the partnership.

(2) When dissolution is caused in contravention of the partnership agreement the rights of the partners shall be as follows:

(a) Each partner who has not caused dissolution wrongfully shall have,

I. All the rights specified in paragraph (1) of this section, and

II. The right, as against each partner who has caused the dissolution wrongfully, to damages for breach of the agreement.

(b) The partners who have not caused the dissolution wrongfully, if they all desire to continue the business in the same name, either by themselves or jointly with others, may do so during the agreed term for the partnership and for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable under clause (2aII) of this section, and in like manner indemnify him against all present or future partnership liabilities.

(c) A partner who has caused the dissolution wrongfully shall have:

I. If the business is not continued under the provisions of paragraph (2b) all the rights of a partner under paragraph (1), subject to clause (2aII) of this section.

II. If the business is continued under paragraph (2b) of this section the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damages caused to his co-partners by the dissolution, ascertained and paid to him in cash, or the payment secured by bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner's interest the value of the good-will of the business shall not be considered.

§420 *BANK OF MONONGAHELA VALLEY v. WESTON.*[1]

Court of Appeals of New York, 1899. [159 N. Y. 201.]

VANN, J.: . . . It is, however, insisted that as the indorsements in question were made after the dissolution, they were the acts of William only, and did not bind the firm because he had ceased to be its agent. A partnership continues, notwithstanding formal dissolution, as to third persons acting in good faith, who have had neither actual nor constructive notice that the firm has been dissolved. The rule is that as to all persons who have had actual dealings with the firm, actual notice of the dissolution must be given (*Vernon v. Manhattan Co.,* 17 Wend. 524; affirmed, 22 Wend. 183; *National Bank v. Norton,* 1 Hill, 572; *Buffalo City Bank v. Howard,* 35 N. Y. 500); as to all who have had no dealings with the firm, but knew of its existence, though not of its dissolution, it is necessary that notice should be published by advertisement in a newspaper. *City Bank of Brooklyn v. McChesney,* 20 N. Y. 240; *Austin v. Holland,* 69 N. Y. 571; *National Shoe & Leather Bank v. Herz,* 89 N. Y. 629; *Elmira Iron & Steel Rolling Mill Co. v. Harris,* 124 N. Y. 280.) It may be that general notice of dissolution, as distinguished from particular notice, can be given in other ways, but we are of the opinion that mere notice to two prominent commercial agencies, the plaintiff not being a subscriber of either, is insufficient, because such agencies circulate the information contained in their books and reports among their customers only, who are required to treat it as confidential in character.

Without prolonging the discussion, we think that the judgment appealed from should be reversed and a new trial granted, with costs to abide the event.

All concur.

Judgment reversed, etc.

§421. *Uniform Partnership Act.*—Sec. 35. (Power of Partner to Bind Partnership to Third Persons after Dissolution.) (1) After dissolution a partner can bind the partnership except as provided in paragraph (3).

(a) By any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution.

(b) By any transaction which would bind the partnership if dissolution had not taken place, provided the other party to the transaction.

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[1]For another portion of the same opinion see §394, *supra*.

(I) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of the dissolution; or

(II) Though he had not so extended credit, had nevertheless known of the partnership prior to dissolution, and, having no knowledge, or notice of dissolution, the fact of dissolution had not been advertised in a newspaper of general circulation in the place (or in each place if more than one) at which the partnership business was regularly carried on.

(2) The liability of a partner under paragraph (1b) shall be satisfied out of partnership assets alone when such partner had been prior to dissolution

(a) Unknown as a partner to the person with whom the contract is made; and

(b) So far unknown and inactive in partnership affairs that the business reputation of the partnership could not be said to have been in any degree due to his connection with it.

(3) The partnership is in no case bound by any act of a partner after dissolution

(a) Where the partnership is dissolved because it is unlawful to carry on the business, unless the act is appropriate for winding up partnership affairs; or

(b) Where the partner has become bankrupt; or

(c) Where the partner has no authority to wind up partnership affairs, except by a transaction with one who

(I) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of his want of authority; or

(II) Had not extended credit to the partnership prior to dissolution, and, having no knowledge or notice of his want of authority, the fact of his want of authority has not been advertised in the manner provided for advertising in the fact of dissolution in paragraph (1bII).

(4) Nothing in this section shall affect the liability under §16 of any person who after dissolution represents himself or consents to another representing him as a partner in a partnership engaged in carrying on business.

§422. *From W. D. Lewis. The Uniform Partnership Act.* 24 *Yale L. J.* 617.—"Section 35 provides that which a partner must do on dissolution to be certain that his co-partners may not, by carrying on the business in the partnership name, against his consent, make him liable for future contracts. The Act provides that a partner cannot, after dissolution, bind the partnership to third persons by any act which is not necessary

to wind up the partnership affairs or complete transactions then unfinished, unless such third person, not having had relations with the partnership by which a credit was extended to the partnership, has no knowledge or notice of the dissolution, and the fact of dissolution has not been published in a newspaper of general circulation of the place (or of each place if more than one) at which the partnership business was regularly carried on, or unless such third person having had relations with the partnership by which a credit was extended, upon the faith of the partnership, has no knowledge or notice of the dissolution. Under existing law it is doubtful in practically all jurisdictions whether the third persons who should receive notice are all those who have had business relations with the partnership, or only those who have had relations with the partnership, by which a credit was extended upon the faith of the partnership. The practical impossibility of the partners knowing, by any feasible system of bookeeping, all the persons with whom they have had dealings, unless credit has been extended, supports the wording by the Commissioners.''[1]

PRACTICE PROBLEMS

(a) A and his son had been conducting a business as co-partners under the firm name and style of "A & Son." When A retired from the firm, leaving his son the sole owner of the business, he consented to the continuance of the business under the old firm name. While on the premises of the concern for business purposes, the plaintiff, an old customer who had not heard of the change in the firm, was injured by the negligence of an employee. Has he an action against the retired partner? See *Jewison v. Dieudonne* (1904), 127 Minn 163.

(b) A, B, and C were partners doing business under the name of A, B, & Co. A retired from the firm but agreed for a valuable consideration to allow his name to be used by the continuing members in firm signatures for all the business purposes of the new firm for ten years. Within this time the firm bought goods from S in the name of "A, B & Co.," and for some of these purchases notes were given, signed

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[1]In further support of the provision as written, see 2 Bates, §§613, 614; Burdick, 57; Mechem, §262; Beale's Parsons, §319; Cal. Civ. Code, §2453; 30 Cyc. 671. There is also other authority for merely requiring that such "third person" shall have had dealings with the partnership. Bates, 612, 613; Collyer, 163; 3 Kent *Comm.* 67; Lindley, 249; Mechem, 261, 262; James Parsons, §§179, 180, 181; Pollock, 98; Shumaker, §121.

"A, B & Co." S knew of the retirement of A and of the above agreement. S sues A, B, and C on the notes given for some of the purchases and also upon open account for the others. Can he recover against A on either or both claims?

(c) A, B, and C were partners. Without any notice to, or settlement with X, one of their creditors, D, was admitted as a partner in the business. The new partnership contracted a debt with Y. Thereafter A, B, C, and D, individually and as partners, became bankrupt. What are the rights of X and Y, respectively? See §356 *supra*.

§423. *Uniform Partnership Act.*—Sec. 40.—(Rules for Distribution.)—In settling accounts between the parties after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

(a) The assets of the partnership are:

I. The partnership property,

II. The contributions of the partners necessary for the payment of all the liabilities specified in clause (b) of this paragraph.

(b) The liabilities of the partnership shall rank in order of payment, as follows:

I. Those owing to creditors other than partners,

II. Those owing to partners other than for capital and profits,

III. Those owing to partners in respect of capital.

IV. Those owing to partners in respect of profits.

(c) The assets shall be applied in the order of their declaration in clause (a) of this paragraph to the satisfaction of the liabilities.

(d) The partners shall contribute, as provided by Section 18 (a) the amount necessary to satisfy the liabilities; but if any, but not all, of the partners are insolvent, or, not being subject to process, refuse to contribute, the other partners shall contribute their share of the liabilities, and, in the relative proportions in which they share the profits, the additional amount necessary to pay the liabilities.

(e) An assignee for the benefit of creditors or any person appointed by the court shall have the right to enforce the contributions specified in clause (d) of this paragraph.

(f) Any partner or his legal representative shall have the right to enforce the contributions specified in clause (d) of this paragraph, to the extent of the amount which he has paid in excess of his share of the liability.

(g) The individual property of a deceased partner shall

be liable for the contributions specified in clause (d) of this paragraph.

(h) When partnership property and the individual properties of the partners are in the possession of a court for distribution, partnership creditors shall have priority on partnership property and separate creditors on individual property, saving the rights of lien or secured creditors as heretofore.

(i) Where a partner has become bankrupt or his estate is insolvent the claims against his separate property shall rank in the following order:

I. Those owing to separate creditors,

II. Those owing to partnership creditors,

III. Those owing to partners by way of contribution.

§424. *From W. D. Lewis. The Uniform Partnership Act.* 24 *Yale L. J.* 617.—"Sec. 40 distinctly states that among the assets of a partnership are 'the contributions of the partners necessary for the payment of all the liabilities.' The adoption of this clause will end the present confusion as to whether the contributions of the partners towards the losses of the partnership are partnership assets or not, a confusion which in the Bankruptcy Act has rendered it possible in some districts to put a partnership containing a solvent partner into bankruptcy."[1]

§425. *From W. D. Lewis. The Uniform Partnership Act. A reply to Mr. Crane's Criticism.* 29 *Harv. L. Rev.*, 291.—"Mr. Crane is of the opinion that the Act, in spite of the Bankruptcy Act, and the almost universal current of authority at common law to the contrary, should have been so drawn as to permit the partnership creditors to share equally in the separate assets of the partner. He makes the usual argument in favor of this change in the law, namely, that the rule giving separate creditors priority on separate assets is not in accord with any theory of partnership. This argument has force, because, at least under the theory on which the Uniform Act is drawn, a partnership creditor is just as much a creditor of a partner as a separate creditor. Those who support the dominant rule do

[1]See *In re Bertenshaw*, 157 Fed. 363 (1907); Contra, *In re Forbes* 128 Fed. 137 (1904). See also *Vaccaro v. Bank*, 103 Fed. 436 (1900); *In re Mercur*, 122 Fed. 384 (1903); *Barry v. Foyles*, I Pet. U. S. 311 (1828); *West v. Lea*, 174 U. S. 590 (1899).

not deny this. All they say is that as the partnership creditors have to be given a priority on partnership assets, to which priority they are not entitled by any equitable superiority of their claims, it is only equitable that a similar priority on separate property should be given to the separate creditors. This "equitable" argument either appeals or not. Once stated, no additional arguments can strengthen or weaken it. It does not appeal to Mr. Crane. It did not and does not now appeal very strongly to the present writer. But he has been forced to recognize that it is an argument which does appeal to the great majority. Each year the members of his law class are overwhelmingly in favor of giving the separate creditors priority on separate assets. A majority of the Committee on Commercial Law of the Commissioners on Uniform State Laws were in favor of such action, and an overwhelming majority of the Commissioners voted for the provision as it stands in the Act after full discussion. Mr. Crane says: "It is not to be expected that a state such as Connecticut, whose highest court after the fullest consideration deliberately departed from the conventional rule, will return thereto in order to secure uniformity." On the contrary, the writer's experience would lead him to believe that the members of the legislature of that state would not hesitate to let the separate creditors have that first chance at separate assets which the partnership creditors must be given on partnership assets, and that the majority of the members of the bar of that state would have no objection to their doing so. However this may be, it is certain that the Act could not pass in most states did it contain the change suggested by Mr. Crane. To which may be added that had the Act given partnership creditors equal rights with separate creditors on separate assets, those advocating its passage in almost all the states would not only be asking their legislatures to change a settled rule of law, but to adopt a different rule than that of the Bankruptcy Act. In the great majority of cases where partners are insolvent, the distribution of their estates takes place under the Bankruptcy Act, and in these cases the rule of distribution provided for by that Act would be followed, without regard to the provisions of any state law. In the few cases in which the

state court directs the distribution, the rules of distribution should not be different than under the Bankruptcy Act. The extent of a creditor's rights should not depend on the tribunal in which he seeks to enforce them.

Sec. 40 (i) provides: 'Where a partner has become bankrupt or his estate is insolvent, the claims against his separate property shall rank in the following order: 1. Those owing to separate creditors; 2. Those owing to partnership creditors; 3. Those owing to partners by way of contribution.'

Mr. Crane says that these rules of distribution introduce three changes into the law as it is established by the weight of authority. Irrespective of whether the Act establishes a rule against that followed by the majority of the conflicting cases—a matter not easily determinable—the writer admits that it was the intention of the draftsmen and the members of the Conference to establish the three so-called changes of which Mr. Crane complains.

One consequence of the wording of the clause criticized will be that the claim of a partner who has paid partnership debts, for contribution on the separate estate of his co-partner, is postponed until all other separate creditors have been paid. Mr. Crane believes that such claim of the partner for contribution should be on an equality with the claims of the separate creditors. It is submitted that the partner, by paying the partnership debts, should be held to have stepped into the right of the partnership creditors against the separate assets of the insolvent partner. He should not obtain, however, in respect to that estate a better position than the person whose claim he has paid. Indeed, if he were allowed to do so, the rule giving priority to separate creditors on the separate estate would be to that extent nullified. It would thus appear that Mr. Crane's criticism is really the result of his objection to the rule that gives priority to the separate creditors.

Another consequence of the clause as worded is that a partner's claim on a matter unconnected with the partnership takes precedence over the claims of the partnership creditors. Mr. Crane objects to this on the ground that it permits the partner to compete with his own creditors. In a sense he is permitted

so to compete, but not for his own advantage. If the claimant partner is solvent and will not pay the partnership creditors, they may attach his claim against the co-partner, put him into bankruptcy, or begin insolvency proceedings against him. This, however, is not the normal situation. If there are partnership creditors making claims on the estate of the insolvent partner it is invariably because, not only one, but all the partners are insolvent. In such case the contest is between the partnership creditors and the separate creditors of each partner. Suppose A., B., and C. are partners, and insolvent. A., on a matter outside of partnership transactions, owes B. $1,000.00. Under the Act this claim of B. is an asset of his separate estate which may be worth something to B.'s separate creditors and, when they are paid, to the partnership creditors. Did the Act follow Mr. Crane's suggestion, the claim of B. would be of no benefit to his separate creditors, because, by supposition, A.'s estate is not sufficient to pay all his separate and all his partnership creditors. Here again the Act as drawn prevents the partnership creditors from obtaining part of the separate estate of a partner—in this case the estate of the claimant partner—until his separate creditors are satisfied.

Lastly, Mr. Crane objects to the preservation of the priority of the separate creditors where there is no partnership estate and no solvent partner. In this much mooted question the Commissioners have followed the opinion of the late Judge Lowell in *Re Wilcox,* 94 Fed. 84. In that justly celebrated opinion the leading judicial authority on bankruptcy showed that the exception to the general rule of priority of the separate creditors on separate assets, for which exception Mr. Crane contends, would be ineffective because there is nothing to prevent the separate creditor from creating a partnership fund by paying a nominal sum for some worthless claim of the partnership. The exception cannot be justified on principle unless the entire rule giving priority to the separate creditors on the separate estate is considered unsound. It is, of course, true that where there is no partnership property the priority of the partnership creditors on partnership property is of no benefit to them. But neither is the priority of the separate creditors on separate

estates of any benefit to them when there are no such assets. Furthermore, the decision in the Wilcox case is now being generally followed as representing the correct interpretation of the present Bankruptcy Act.

C. In Corporations

§426 *THE BOSTON GLASS MANUFACTORY v. LANGDON.*

Supreme Judicial Court of Massachusetts, 1834. [24 *Pick.* 49.]

Assumpsit on a promissory note given by the defendant to the plaintiffs. The defendant pleads in abatement, that at the time of the purchase of the writ there was not, and now is not, any such corporation established by law, called the Boston Glass Manufactory, as in and by the writ is supposed. The plaintiffs' reply that there was and is such a corporation; and tender an issue; which is joined.

At the trial, before MORTON, J., the plaintiffs offered in evidence their act of incorporation, and showed their organization under it in 1811.

The records of the corporation were introduced by the plaintiffs, and were used and relied upon by both parties.

The defendant then introduced an indenture, dated the 27th of May, 1827, assigning all the property of the corporation to certain persons, in trust to pay, *pro rata,* such creditors as should become parties to the indenture. This instrument contained covenants, that the assignees might use the name of the corporation in the collection of the debts, and in the disposition of the property assigned; that the corporation would not hinder or obstruct them in the performance of these functions; and that it would make any further conveyances and assurances which might become necessary, and perform any other and further acts which might be required to enable the assignees fully to execute their trust. No provision was made for a release to the corporation by the creditors, nor for paying over to the corporation the surplus, if any, of the property assigned. The defendant also referred to all the records subsequent to 1817, and contended that the assignment of the property of the corporation, and the omission to hold annual meetings, to choose directors, and to transact business, as appears by the records and books of the corporation, supported the issue on her part and entitled her to a verdict.

But the jury were instructed that the evidence was com-

petent to prove the establishment and continuance of the corporation down to the present time.

The plaintiffs then claimed to have the damages assessed by the jury, if they found a verdict in their favor, and offered in evidence the note declared on. This was objected to by the defendant, because the note had been assigned. But the objection was overruled.

The defendant then offered to prove that the note was without consideration. This evidence was objected to and was excluded.

The jury found a verdict for the plaintiffs for the whole amount of the note and interest.

The defendant excepted to the decisions and instructions of the judge; and for the reasons above appearing, moved for a new trial.

MORTON, J., delivered the opinion of the Court. The nonexistence or death of the plaintiff may properly be pleaded in abatement. 1 Chitty's *Pl.* 482; Story's *Pl.* 24. But whether, as it entirely and perpetually destroys the plaintiff's right to recover, it may not also be pleaded in bar, it is not necessary to determine. *Proprietors of Monumoi v. Rogers,* 1 Mass. R. 159; *First Parish in Sutton v. Cole,* 3 Pick. 245. Whether the plea conclude in abatement or bar, the issue being found against the defendant, the judgment must be peremptory. The established rule is, that in dilatory pleas, when the issue is found against the defendant on matters of fact, the judgment must be in chief. Gould's *Pl.* 300; Howe's *Pract.* 215.

The principal question for our consideration is, whether judgment shall be rendered on the verdict. The defendants' counsel contends that the evidence introduced will not support the verdict, but that the verdict is against the evidence and the law and should be set aside.

The point which has been determined by the jury, though necessary to be submitted to them with proper instructions, is quite as much a matter of law as of fact; and we the more readily enter into the examination of it.

The legal establishment and due organization of the corporation were admitted; but it was contended that the facts disclosed showed a dissolution of it.

The elementary treatises on corporations describe four methods in which they may be dissolved. It is said that private corporations may lose their legal existence by the act of the legislature; by the death of all the members; by a forfeiture of their franchises; and by a surrender of their charters. 2 Kyd on *Corp.* 447; 1 Bl. *Comm.* 485; 2 Kent's *Comm.* (1st ed.)

245; Angell & Ames on *Corp.* 501; *Oakes v. Hill,* 14 Pick. 442. No other mode of dissolution is anywhere mentioned or alluded to.

1. In England, where the parliament is said to be omnipotent and where in fact there is no constitutional restraint upon their action, but their own discretion and sense of right, corporations are supposed to hold their franchises at the will of the legislature. But if they possess the power to annul charters, it certainly has been rarely exercised by them. In this country, where the legislative power is carefully defined by explicit fundamental laws, by which it must be governed and beyond which it cannot go, it has become a question of some difficulty to determine the precise extent of their authority in relation to the revocation of charters granted by them. But as it is not pretended that there has been any legislative repeal of the plaintiffs' charter, it will not be useful further to discuss this branch of the subject.

2. As all the original stockholders are not deceased, the corporation cannot be dissolved for the want of members to sustain and exercise the corporate powers. Besides, this mode of dissolution cannot apply to pecuniary or business corporations. The shares, being property, pass by assignment, bequest, or descent, and must ever remain the property of some persons, who of necessity must be members of the corporation as long as it may exist.

3. Although a corporation may forfeit its charter by an abuse or misuser of its powers and franchises, yet this can only take effect upon a judgment of a competent tribunal. 2 Kent's *Comm.* (1st ed.) 249; *Corporation of Colchester v. Seaber,* 3 Burr. 1866; *Smith's case,* 4 Mod. 53. Whatever neglect of duty or abuse of power the corporation may have been guilty of, it is perfectly clear that they have not lost their charter by forfeiture. Until a judicial decree to this effect be passed, they will continue their corporate existence. *The King v. Amery,* 2 T. R. 515.

4. Charters are in many respects compacts between the government and the corporators. And as the former cannot deprive the latter of their franchises in violation of the compact, so the latter cannot put an end to the compact without the consent of the former. It is equally obligatory on both parties. The surrender of a charter can only be made by some formal solemn act of the corporation; and will be of no avail until accepted by the government. There must be the same agreement of the parties to dissolve, that there was to form the compact. It is the acceptance which gives efficacy to the surrender.

The dissolution of a corporation, it is said, extinguishes all its debts. The power of dissolving itself by its own act would be a dangerous power, and one which cannot be supposed to exist.

But there is nothing in this case which shows an intention of the corporators to surrender or forfeit their charter, nor anything which can be construed into a surrender or forfeiture.

The possession of property is not essential to the existence of a corporation. 2 Kent's *Comm.* (1st ed.) 249. Its insolvency cannot, therefore, extinguish its legal existence. Nor can the assignment of all its property to pay its debts, or for any other purpose, have that effect. The instrument of assignment was not so intended, and cannot be so construed. All its provisions look to the continuance of the corporation. It contains covenants that the assignees may use the corporate name for the collection of the debts and the disposition of the property assigned; that the corporation will not hinder or obstruct them in the performance of these functions; that it will make any further conveyances and assurances which may become necessary, and will do and perform any other and further acts which may be required to enable the assignees fully to execute their trust. The instrument which covenants for future acts cannot be construed to take away all power of action.

The omission to choose directors clearly does not show a dissolution of the corporation. Although the proper officers may be necessary to enable the body to act, yet they are not essential to its vitality. Even the want of officers and the want of power to elect them would not be fatal to its existence. It has a potentiality which might, by proper authority, be called into action, without affecting the identity of the corporate body. *Colchester v. Seaber*, 3 Burr. 1870.

But here in fact was no lack of officers. Although no directors had been chosen for several years, yet, by the by-laws of the corporation, the directors, though chosen for one year, were to continue in office till others were chosen in their stead.

The damages were properly assessed by the jury. The defendant having elected to try her case upon a plea in abatement, must submit to the legal consequences of that form of trial. Perhaps the Court might have assessed the damages as in case of default. But most obviously the better course was to submit the subject to a jury. In doing this the defendant could not be allowed to go into the whole defence as upon the general issue. The rule adopted at the trial was the correct one.

Judgment according to verdict.

§427. *Non-user Not a Mode of Dissolution of Corporations.* —Among the modes of dissolution of a corporation, non-user is not mentioned. Contrast the situation in partnership and agency. It is important for business men to understand the necessity of winding up the affairs of the corporation before it is abandoned. Otherwise, they may find themselves responsible for franchise and similar taxes, as long as the corporation is permitted to endure on paper. The ease with which corporations can be organized under our statutes and the obvious advantages that they offer—particularly that of limited liability—have caused innumerable corporations to come into existence which are corporations in name only. It is a common discovery among accountants and lawyers that the unbusinesslike methods described in the above case with reference to the books of the company, meetings of stockholders and directors, elections, and the like, are too freely indulged in. Nevertheless, such organizations do not cease to be corporations in the eyes of the law so long as they are not dissolved in one of the recognized ways.

§428. *From Edward H. Warren. Voluntary Transfers of Corporate Undertakings.* 30 *Harv. L. Rev.* 335.—"In the several states of the United States there are now express statutory provisions respecting the voluntary dissolution of corporations. The state consents to accept the surrender on terms.

There is no uniformity in these statutes, but the following classification may be made:

Indiana, Iowa, and Ohio it is provided that the dissolution may only be by the unanimous consent of the members.

In Florida, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, New Hampshire, Pennsylvania, Rhode Island, and Vermont it lies in the discretion of a court to decree a dissolution. The matter may be brought before the court in various ways, usually by vote of a majority.

In Alabama, Arkansas, California, Idaho, Montana, North Dakota, Oklahoma, South Dakota, Utah, and Washington a vote of the holders of a specified proportion of the stock is required, and the matter is then brought before the court for confirma-

tion. But the statutes (if they may be taken at their language value) limit the function of the court to determining whether the provisions of the statutes have been complied with.

In Arizona, Colorado, Connecticut, Delaware, Idaho, Illinois, Kansas, Kentucky, Louisiana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, Oregon, South Carolina, Texas, Virginia, West Virginia, Wisconsin, and Wyoming a vote of the holders of a specified proportion of the stock is required, and there is no necessity of confirmatory court action.

In Georgia the statutes do not provide any method of voluntary dissolution. In Tennessee the statute has been interpreted to give the court authority to declare a corporation dissolved, upon a surrender. But the statute is silent as to how the surrender may be made."

§429 *NOBLE et al. v. GADSDEN LAND & IMPROVEMENT CO.*

Supreme Court of Alabama, 1901. [133 *Ala.* 250.]

TYSON, J.: The bill in this cause after amendment is the complaint of three stockholders owning in the aggregate twenty-eight hundred shares of the capital stock of the respondent corporation, and prays to have the corporation dissolved and its assets, which consist of six hundred acres of land, sold and its proceeds distributed among the stockholders, for general relief, etc. The corporation is a private trading one and has a capital of two millions five hundred thousand dollars ($2,500,000), divided into twenty-five thousand (25,000) shares of the par value of one hundred dollars ($100) each. The purpose of its organization was the building of a town upon the tract of land owned by it. To this end, this land was to be divided into lots, to be sold to those who could be induced to purchase them, and the company was to procure, if possible, the location of industrial enterprises on its lands and thus enhance its value and make salable its lots. In short, it is what is known as a "boom concern." It was organized when the country was rife with speculation; and now that conservatism in financial matters has returned, after a severe experience during the years of financial depression, the company is left with this tract of land, and nothing more, worth probably fifteen or twenty thousand dollars. Fortunately, it has no creditors, and, therefore, no one

interested in its affairs, except its stockholders, who are shown to have abandoned the enterprise, leaving it to be managed by its board of directors as best they can. For five years, its president and secretary have made diligent efforts to have the stockholders meet. Many of them are non-residents of this state, and those who are residents decline to attend the meetings when called, after being notified and urged to do so. There are three hundred and forty-five of them, and the whereabouts of one-third of the number is unknown and unascertainable, and the remaining two-thirds have lost all concern or interest in the affairs of the company. The fixed charges which the corporation is bound to meet annually, in the way of taxes, licenses, etc., is between six and seven hundred dollars. Its income annually is only about fifty dollars. So that, each year a portion of its tract of land is sold by the state, county and city of Gadsden to pay these charges. It is wholly without credit and its assets are being sacrificed, the corporation, on account of the abandonment of it by the holders of the majority of its stock, being powerless to prevent it.

It is upon substantially the foregoing state of facts, which is shown both by the averments of the bill and the testimony, that the complainants seek relief.

On final hearing the chancellor dismissed the bill for want of equity, holding that, in the absence of a statute, the chancery court is without jurisdiction to dissolve the corporation and to distribute its assets at the suit of a minority stockholder.

Where the corporation is a going concern, it is undoubtedly true that a minority stockholder cannot maintain a bill to have it dissolved or to have its assets distributed. In such case, the shareholders who disapprove of the company's management or consider their speculation a bad one, their remedy is to elect new officers or to sell their shares and withdraw. "They cannot insist on having the company's business closed and the assets distributed, against the will of a single shareholder, who wishes to have the business continued." 1 Morawetz on *Corp.* §283. But where the corporation has been abandoned by its stockholders, as here, and is, therefore, powerless to protect its assets, and to discharge its duty to the stockholders as their trustee, minority stockholders who are *cestuis que* trust, if the chancery court has no jurisdiction to rescue the trust fund from the perils endangering its destruction, would be remediless. No efforts of theirs to have their trustee sell the lands and distribute its proceeds could avail them, for the obvious reason, that it would require the consent of the holders

of a majority of the stock to thus strip the corporation of its assets, which is shown in this case cannot be obtained, not because of their unwillingness to give it, but on account of their lack of interest in the company. Clearly its directors cannot do so, the corporation not being insolvent. They are merely the managing agents of the business of the corporation, to promote the ends designed by its charter and do not possess such power or authority. *Elyton Land Co. v. Dowdell,* 113 Ala. 186; 3 Thompson on *Corporations,* §3983; 1 Morawetz on *Corp.* §513; 2 Cook on *Corp.* (4th ed.), §670. These complainants desiring, as they do, to have this trust fund protected and administered so as they may get their part of it, have in our opinion, under the facts of this case, the right to maintain this bill to have the lands sold and its proceeds distributed among the stockholders. On former appeal (*McKleroy v. Gadsden Land & Improvement Co.,* 126 Ala. 193), we said: "It is held in *Planters Line v. Waganer,* 71 Ala. 581, that a private corporation, entered into solely for benefit of the shareholders, and involving no public duty, may be dissolved by the stockholders; and on the same principle, when the purpose of such an association is a failure, we quite agree with Mr. Thompson that there should be in the chancery court an inherent power to administer the property so as to restore to the *cestuis que trustent* (the stockholders) their ultimate interest.—4 Thomp. on *Corp.* [§§4443, 4538] §4545; *Fougeray v. Cord,* 50 N. J. Eq. 185; *Price v. Holcomb* (Iowa), 56 N. W. Rep. 407." In 1 Morawetz on *Corp.,* §284, it is said: "Whenever, in the course of events, it proves impossible to attain the real objects for which a corporation was formed, or when the failure of the company has become inevitable, it is the duty of the company's agents to put an end to its operations and to wind up its affairs. Under these circumstances, the majority would have no right to continue to use the common property and credit for any purpose, because it would be impossible to use them for any purpose authorized by the charter. If the majority should attempt to continue the company's operations in violation of the charter, or should refuse to make a distribution of the assets, any shareholder feeling aggrieved would be entitled to the assistance of the courts and a decree should be made ordering the directors to wind up the company's business and distribute the assets among those who are equitably entitled." See also section 412 of same book. . . .

The decree dismissing the bill for want of equity will be reversed and the cause remanded, with directions to the lower court to enter a decree ordering a sale of the land for distribu-

tion, and for such other orders or decrees as may be necessary to an equitable and orderly administration of the trust estate.

Reversed and remanded.

§430 *NATIONAL BANK OF UNION POINT et al. v. AMOSS et al. and VICE VERSA.*

Supreme Court of Georgia, 1915. [144 *Ga.* 425.]

Error to Superior Court, Hancock County:

PARK, Judge.

Action by Sparta Cotton Mill *et al.,* plaintiffs, against creditors and certain stockholders of said corporation. To review judgment rendered, National Bank of Union Point *et al,* bring error. G. M. Amoss *et al.* file cross-bill of exceptions.

The Sparta Cotton Mill and its directors, who also sued as stockholders, brought an action against the other stockholders and creditors of the corporation, for equitable adjudgment of the stockholders' liabilities and for marshaling and distribution of its assets. The petition alleged that the persons named as stockholders undertook to form a corporation, and signed the following subscription agreement: "Sparta, Georgia, March 27, 1907. For the purpose of organizing the Sparta Cotton Mills, a corporation to be capitalized at $100,000, as follows: $50,000 of preferred stock, and $50,000 of common stock, each class of stock to be of the par value of $100 per share, we, the undersigned, subscribe and will pay for as called by the directors of the corporation the amount set opposite our respective names (whether subscriptions are for preferred or common stock to be designated below). The preferred stock shall have preference both as to principal and dividends, the dividends on the preferred stock to be seven per cent. per annum, and guaranteed, and no dividends shall be paid on common stock until after dividends on the preferred stock shall have been paid. In view of these preferences the preferred stock shall have no voting power, which power shall be vested entirely in the common stock, and the preferred stock shall not share in the profits of the corporation beyond its annual dividend of seven per cent; any profits that may be earned by the corporation in excess of this guaranteed dividend is to be paid only to the holders of common stock. If deemed advisable by a majority in amount of the subscribers hereto, the proportion of the preferred and common stock hereinbefore indicated may be changed so that there may be a greater proportion of common stock, but in no event shall the preferred stock be more than fifty per cent of the capitalization stated above. It is understood and agreed

between the subscribers hereto and R. F. Bryan and J. W. Griffin, that the last-mentioned party will, for and in consideration of the sum of forty-two thousand ($42,000) dollars, convey by warranty deed, free from all liens or incumbrances, to the subscribers hereto all the lands now owned by the Sparta Oil Mill, except the oil machinery and property strictly pertaining to the oil business and ginhouse and ginnery, same being detached and in no way interferes with the cotton-mill property, which is to be removed within a reasonable time from its present location. The subscriptions hereto shall become binding and effective when seventy-five per cent of the total capitalization of the corporation shall have been subscribed.''

On June 24, 1907, a charter having been obtained, the corporation was organized, officers elected, and by-laws for the government of the institution were passed. At this meeting it was ascertained and spread upon the minutes that 224 shares were to be preferred stock and 454 shares were to be common stock; and a form of certificate was devised and adopted to define the status and the rights of the preferred stockholders, and the same was spread upon the minutes. Calls for the payment of the stock subscriptions were duly made, and notice given to each stockholder. The directors purchased from the Sparta Oil Mill the property described in the subscription agreement (known as the Montour Mills property), except the power-plant, for the sum of $37,000. The power-plant was deemed inadequate for the purposes intended, and the purchase-price was reduced $5,000. Some of the subscribers paid for their stock in full, some in part, and some have not paid. The directors made ineffectual efforts to operate the property, and in so doing incurred certain debts. It was difficult to get a meeting of the stockholders, but finally a majority of the common stock and 95 per cent. of the shares of the preferred stock were represented at a meeting held on February 23, 1911, at which meeting, after re-electing petitioners as directors, the stockholders voted to liquidate the affairs of the company; and this petition is filed for the purpose of marshaling and distributing the assets upon equitable principles, and for other relief ancillary thereto. . . .

EVANS, P. J. (after stating the facts): . . . 5. In his findings of law the auditor reported that the undesignated stock subscriptions should be held and deemed subscriptions for common stock, unless a preference had been asked prior to the organization, or was given by the unanimous consent of all stockholders subsequent to such time. The subscription agreement contemplated that the subscribers should designate

whether their subscription was for preferred or for common stock; and this was done by many subscribers. Some did not indicate for which class of stock they subscribed, and assert that they have a right of election after the organization of the corporation. The usual relation between a corporation and its stockholders is that of holders of common stock. It requires a special agreement to demand preferred stock. The subscribers who did not designate the class of stock to which they subscribed were liable as common stockholders when the corporation was formed. Thereafter the right to an issue of preferred stock would depend, as the auditor held, either upon unanimous consent or corporate action. Cook on *Corp.* §§268, 269.

6. The auditor reported, "that, the Sparta Cotton Mill having become insolvent, all unpaid subscriptions both on common and preferred stock constitute a trust fund for the benefit of creditors; that if no assessments of preferred stockholders be necessary for the benefit of creditors, then the unpaid common stock subscriptions are liable, first to the creditors, second to the preferred stock paid up, and finally common stockholders are liable under their subscriptions for assessments among themselves, according to their respective rights, in proportion to the amounts already severally paid, in order to equalize such payments." It will be remembered that the subscription contract contained this provision: "The preferred stock shall have preference, both as to principal and dividends," etc. The evidence before the auditor authorized a finding, and the auditor found, as a matter of fact, that the stockholders accepted the charter, organized the corporation, elected officers, and ordained by-laws. At the October, 1907, meeting the directors adopted a prescribed form for the preferred stock, which contained this provision: "In case of liquidation or dissolution of the company, or distribution of the assets, the preferred stock shall be entitled to be paid in full at par, and accrued dividend charges, before any payment is made on the common stock. After such payment the common stock is entitled to the total remaining assets." In a subsequent meeting of the stockholders, held on July 14, 1908, a resolution was passed and duly entered upon the minutes, declaring that the preferred stock certificates adopted by the directors were in accordance with the original subscription list, and the same was approved and adopted by the stockholders. Subsequent meetings were held in which stockholders of common and preferred stock issued under this authority participated. The general rule is, that, in the absence of any special stipulation either by statute or by agreement, the holder of preferred shares is entitled to preference

only in the distribution of dividends, and not in the distribution of capital. The matter may be governed by a contract which will give the holder of preferred stock preference in the distribution of assets. 4 Thomp. *Corp.* §3613. The conclusion of the auditor, giving a preference to preferred over common stockholders, was in accordance with the contract between the corporation and the stockholders.

7. The Sparta Oil Mill held the note of the Sparta Cotton Mill for a balance of $2,421.26. The indebtedness represented by this note was allowed by the auditor as a valid obligation of the Sparta Cotton Mill. The court in his judgment reversed this finding of the auditor. That indebtedness arose in this way: In March, 1907, J. W. Griffin, R. F. Bryan, and E. A. Rozier were the principal owners of the Sparta Oil Mill. The oil-mill owned the property known as the Montour Cotton Mills property. This property had been purchased about four years before, for the sum of $9,000. It was located some distance from a railroad. In March, 1907, Griffin solicited subscriptions for the cotton-mill. Griffin, Rozier, and John D. Walker each subscribed for $5,000, and Bryan subscribed for $10,000 of the stock. The subscription list contained an option to purchase this property at $42,000. The Sparta Cotton Mill was incorporated on June 24, 1907. The corporation was duly organized, officers were elected, and by-laws adopted. At a meeting of the stockholders a resolution was passed and entered upon the minutes, confirming the purchase of the Montour Mills property for $37,000 (the price being reduced $5,000 in consideration of eliminating the power-plant, which was deemed inadequate). The title of the property was investigated and a deed was made to the Sparta Cotton Mill in consideration of $37,000. Of this amount $17,000 was paid in money and notes, and $20,000 was taken in stock by the owners of the oil-mill. The auditor found that the value of the oil-mill property at the time of the subscription and at the time of its sale was about $15,000, and that that value would probably be enhanced $7,500 on account of its availability for cotton-mill purposes. At the same time the auditor found that the sale of the Montour property by the Sparta Oil Mill to the Sparta Cotton Mill was free from fraud. As stated in his opinion, the trial judge held, on the principle that he who seeks equity must do equity, that inasmuch as the owners of the Sparta Oil Mill stock had already received $17,000, the value of the property as found by the auditor, they were not entitled to recover the balance of the purchase-money represented by the note. It is true that in the distribution of the assets of an insolvent corporation it will be

done equitably. But it is not equitable that a clear property right shall be taken away from one man to lessen the misfortune of a disastrous financial venture of his associates. This is not a question of rescission of the contract on the ground of inadequacy of price. The Sparta Cotton Mill bought the property at an agreed price. The auditor found that there was no fraud practiced in its purchase, and the trial judge approved that finding, after an elaborate review of the evidence. The fact that the auditor was of the opinion that the property was of less value than the parties contracted to pay for it will not justify the court in reducing the price which the parties to the contract had agreed upon. Indeed, by an interlocutory order passed prior to the final judgment complained of, the court had directed that this property be sold as the property of the Sparta Cotton Mill; and the proceeds of the sale are a part of the assets to be distributed. The trade never was rescinded, but was held to the very last; and under these circumstances we think the court erred in disallowing this item as a valid obligation.

§431 *DRENNEN v. MERCANTILE TRUST & DEPOSIT CO.*

Supreme Court of Alabama, 1897. [115 *Ala.* 592.]

COLEMAN, J., *dissenting*: The Mary Lee Coal & Railway Company, a corporation, authorized by its charter to own and operate coal mines, coke ovens and a railway, in Jefferson county, to secure its bonded indebtedness executed a deed of trust to the Mercantile Trust & Deposit Company, the appellee, upon all its property, and tolls, charges, and its income. Having defaulted, the trustee filed a bill, praying for a receiver, and foreclosure of the mortgage. Pending the foreclosure bill, the appellants, Drennen & Company, by petition interposed a claim for fourteen thousand, six hundred and ninety-seven dollars, and prayed that it be allowed as a preferred claim. The basis of this claim is, that it was "due for repairs and work and labor done and performed for the defendant, the Mary Lee Coal & Railway Company, during the months of July, August, September, October and November," preceding the filing of the bill. Of the amount claimed, about $8,947 was due for digging and mining and shipping coal, and in keeping said mine in operation and in preparing said coal for shipment; that about $5,000 was due in operating and repairing said coke ovens, and in preparing coke for shipment to market, and about $750 was due for operating and repairing defendant's said railroad. The

real issue involved, is whether the doctrine believed to have been first promulgated in the case of ***Fosdick v. Schall,*** 99 U. S. 235, which allowed wages earned within six months before the appointment of a receiver, preference and priority over the bondholders whose debts were secured by a mortgage preceding the accrual of the claim for wages, and which doctrine, by that decision and others since rendered, was expressly limited to public railroads, shall be further extended, and as extended be applied to private business corporations, companies and individual transactions. The principle asserted and the rule adopted for its application in the opinion of the court, logically leads to this result. No case has been cited in support of the contention, and the writer believes it is without precedent.

New and useful inventions for the benefit of mankind are commendable, but the province of courts is to apply existing principles, and not create rules and principles which injuriously affect the rights of parties, acquired by contract. The province and power of courts of equity to intervene for the protection of right and prevention of wrong, and to invent remedies where none exist, to secure these ends, is one of its most useful attributes, and the exercise of this power on proper occasions, has developed into our present admirable system of equity jurisprudence; but there is a great and irreconcilable difference between the application of a remedy, and the creation of a right and priority, which subverts and subordinates existing contractual interest. It has been truly said, that under some circumstances courts of equity may amplify remedies, but cannot dispense with legislation, nor amplify jurisdiction.

The reasons now assigned for this new departure have been obvious to the judicial mind for a century or more, and the very fact that the conclusion has not hitherto been accepted as sound and permissible, of itself is full of warning to that conservatism which should characterize courts of justice. Precedents, though not always entitled to absolute domination, when they have become so established as to enter into and become elements of contract, cannot be set aside by courts without inflicting injustice. The legislative department has no authority, by its enactments, to impair the obligation of contracts, and surely courts of justice ought not, by their adjudications, to adopt and apply principles to existing contracts, which will have the effect of an *ex post facto* legislative enactment.

It is unnecessary to cite authority in support of a proposition of law, recognized in all courts and especially in this state, to the effect that in the absence of an agreement to the contrary, at common law, a mortgage upon property carried with

it all subsequent improvements, repairs and betterments; and this rule prevails until changed by statute in courts of equity as well as law in all states, where the common law exists. Nor is it necessary at this late day, to cite the authorities which have upheld the validity of mortgages, including those of railroads upon after-acquired property, and tolls and charges and incomes. It was the prevalence of these rules, which led to the enactment of what are known as the "mechanics' and materialmen's lien laws" and statutes, giving priority for labor and supplies and materials, the constitutionality and application of which statutes have undergone so many exhaustive discussions in the courts of the country. In no case that is now recalled have these statutes been sustained in so far as they were intended to "displace" or subordinate prior liens and contracts; nor can there be found a decision, in my opinion, which demanded of the owner of a right, vested in him by virtue of a prior valid contract, that he concede something of his rights, as a condition precedent to his obtaining the aid of the courts of the country. I am not now construing the question of the unqualified right of a suitor to a receiver in a proper case, and the terms a court may impose as a condition to the appointment of a receiver, nor the power of a court to create prior liens for the preservation of property held by it during the pendency of litigation. The principle asserted in the case under consideration goes far beyond all these rules and regulations incident to the appointment of receivers and the preservation of property. It boldly announces as a universal principle of "abstract equity," not dependent upon contract nor affected by contract, "and which needs no other justification for its application in any case than the existence of facts upon which it arises and rests." I quote from the opinion itself as follows:

> "Enough has, we think, been said by ourselves and through our adoption of the language of Judge WAITE to demonstrate that the equity of the doctrine lies solely in the facts that the gross income of the corporation which in good conscience belongs to its laborers and operatives has been, in one form or another, diverted from them and converted directly or indirectly to the use, benefit and behoof of the bondholders to whom in equity and good conscience it does not belong, whether the mortgages securing the bonds in terms embrace income or not, until the wages of laborers and operatives and the accounts of supply or material-men for labor done and supplies furnished recently before the appointment of the receiver have been paid. And this is the whole

equity, and it is in itself a perfect equity. The fact that the corporation is of a public character does not enter into it and is not an element of it, any more than such fact would be necessary to a recovery in trover for a horse converted by a corporation. Every element of this equity may exist as well against a private as against a public corporation, and against bond creditors of the one as well as the other. The right to be asserted is obviously the same whatever the character in this respect of the corporation. The wrong done to the employees is the same—the misappropriation of the fund for the payment of their wages. And the remedy for the effectuation of the right and the redress of the wrong is applied upon considerations which take no account of whether the corporation whose earnings have thus been wrongfully diverted from the payment of its employees is a railroad company, a manufacturing company or a mining company. The diversion of the fund being shown and the equity being thus made to appear, the redress is accorded, the equity is declared and effectuated by courts of chancery upon the broad and beneficent maxim of equity jurisprudence which imposes, or authorizes the court to impose, upon every suitor, asking equitable relief the duty and burden of doing equity, and we have not heard or seen it suggested that this principle is applicable more to one suitor than another or more to a public than a private corporation. The necessity for the application of this equitable doctrine for giving preference to claims of employees for wages is doubtless more frequent in railroad cases, but that does not argue that the facts which authorize it cannot as well exist in other cases, so there is more necessity ordinarily for a railroad corporation to be kept a going concern because of the duty it owes the public and the character of its business, and hence it is true that the facts stated constituting the equity of the doctrine in the third category, *supra*, exist more frequently in respect of railroad property. But there may well be, from the point of view of the bondholders, as much necessity to keep the works of a private corporation going in order to protect and preserve the property which is the bondholders' security as also to earn income for the payment of current expenses and the principal and interest of the bonds. And the necessity of keeping the corporation a going concern is in all cases gauged, not from the standpoint of the

> public, but from the standpoint of the bondholders, and for the purpose of determining, not what injury the public would have suffered from the stoppage of the works, nor how they have been benefited by the continuation of the business, but what injury the bondholder would have suffered from such stoppage in the loss of net income and in the diminution of the value of the property, with a view to measuring the benefits he has received from the labor of employees in continuing to carry on the operations of the corporation. The damages and loss to the bondholder from a stoppage of the operations of a railroad would generally be greater than from the stoppage of the works of a mining company; but whether greater or less they stand upon the same footing as a measure of the benefit accruing to him from the labor which prevented their infliction upon him; the difference is one of quantity and not of kind.''

It must be observed that the ''equity'' here asserted, is not made to depend upon any statute, or agreement to that effect, in favor of the ''wages of laborers and operatives and the accounts of supply or material-men for labor done and supplies furnished recently before the appointment of the receiver;'' and until paid made a prior charge upon the gross income proceeding from such consideration, or if such income has been otherwise expended, than upon the corpus into which consideration entered. The predicate for the argument is, ''that the gross income *belongs* to the laborers and operatives and material-men, which in one form or another has been diverted from them and converted directly or indirectly to the use, benefit and behoof of the bondholders, to whom *in equity and good conscience it does not belong*, whether the mortgages securing the bonds in terms embrace income or not until these wages and material-men have been paid.'' We have italicized the words which are made the pillars of the argument. Is it a fact, that the gross income covered by a prior executed mortgage, known to the parties, belongs in any sense to the laborer or material-men as a matter of equal or equitable right; and that it does not belong to the bondholder, although by contract he has secured a prior lien, which lien existed, and which the laborer and material-men knew existed when the services were rendered and the supplies or material were furnished? Have we discovered or invented a legal X-ray which exposes to the judicial eye an imperfection in the old doctrine of contract on personal credit, or manifests as unsound, the rule which declares contracts to be sacred and inviolable? If the income *belongs* to the laborer he ought to be

able to recover it in an action for money had and received, and not by a judgment for services rendered. If he or the materialman has a lien upon or prior claim to the income, or upon the "corpus into which the labor or material has entered," as an "abstract" and "perfect equity," independent of contract or statute, the judicial mind for a century or more has been grossly at fault. The interventions of legislatures to provide for labor and material furnished, and the study and worry of courts to adjust the rights of contractors and prior mortgages under these statutory enactments, were to a great degree superfluous and labor lost, for if the doctrine now contended for be sound, there arose from the facts, without the statute, or agreement, a perfect equity, which only needed application and enforcement. If the doctrine now contended for is sound, there must arise on every farm, in every manufactory, mine and enterprise in which labor is performed and material furnished from which a gross income is derived, the same rights and equity, independent of and superior to the claims of all other creditors without regard to previous or subsequent contracts. If the perfect equity exist, the arbitrary limitation by some courts to six months within which such claims may be enforced is a tyrannical usurpation by the courts.

We cannot reasonably presume that the distinguished court which rendered the decision of *Fosdick v. Schall*, 99 U. S. 235, *supra,* and subsequent decisions in line with it, did not clearly perceive the full force of the argument and "abstract equity" now insisted upon successfully for the first time in this or any other court, at least within the knowledge of the writer, and apprehended the nature and consequences involved. That court did not attempt to justify the new rule adopted upon the ground that the petitioners had an abstract equity, perfect in itself, superior to the bondholders, but based its conclusion upon the power of the court to impose conditions precedent to the appointment of receivers and the granting of equitable relief, and justified the imposition of these conditions because of the public character of railroad corporation, and limited its application to such enterprises, and to cases in which the mortgagee applied to courts of equity for affirmative relief. In the case of *Kneeland v. Trust Company,* 136 U. S. 89, that court has already issued its warning, that the rule will not be extended to other than the exceptional case specified, and reaffirmed the established doctrine in the following language: "No one is bound to sell to a railroad company or to work for it, and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its per-

sonal responsibility, and not in expectation of subsequently displacing the priority of the mortgage lien." How is it possible to reconcile the doctrine enunciated in *Kneeland v. Trust Co.*, 136 U. S., *supra*, with that enunciated in the case at bar, where the rule is applied to "improvements which add value in a sense permanent to the property," and which holds that if the income has been otherwise expended, then these claims become a prior lien upon the "corpus" to which the labor or materials of claimants contributed nothing, and which originally constituted the security of the mortgage? The writer cannot sanction as sound a rule of equity which annuls (usually termed "displaces") existing relations between a mortgagor and mortgagee, in the interest of a third party, whose interest was acquired against the mortgagor, subsequent to and with a full knowledge of the rights of the mortgagee.

The justification of the courts, denying a mortgagee his priority, has been rested mainly upon, first, the equitable doctrine, that he who seeks equity must do equity, and secondly, upon the equitable doctrine of estoppel, and thirdly, that the claim is one of abstract right arising from certain conditions and circumstances.

As to the first of these propositions, that he who seeks the aid of a court of equity must do equity, the rule operates only between the parties to an agreement or transaction to prevent the one from taking an undue advantage of another, but cannot be invoked by a stranger, who is not even a proper party to the suit. But the argument assumes the question in controversy, and that is, that these claimants have an equity peculiar to them because of the character of the claims. These claims must necessarily arise either from contract, express or implied, or from statute, or result into such superior claims as matter of law from facts. It is not pretended that the right is of statutory creation, or of contract between the parties, the mortgagee and labor or material creditor, nor between the mortgagor as the agent of the mortgagee, and the labor or material creditor.

Is it a conclusion of law that a mortgagee guarantees to laborers and material-men, that the business of the company or corporation will be conducted on business principles, and the company never become insolvent? Is it a conclusion of law that a mortgagee's lien shall be subordinate to claims for labor and material? Is it a conclusion of law that a lien upon incomes acquired by solemn contract is subordinate to such claims? And on the other hand, is the right of the laborer or material-man made by law to depend upon the skill and judg-

ment of the employer, so that if permanent injury results his claim becomes thereby of a higher and superior character? or does it depend upon how the gross income be expended by the employer? If this be law, it is because the courts make it law, and in no sense is it the application of any just principle.

Contracts for labor and material, unaided by special provision of the contract or statute, stand on no higher ground than other simple contract creditors, and are no more entitled to the income than the latter creditors. Labor and material claimants have as much right to have a simple contract creditor, to whom income has been paid, declared a trustee for their benefit, as to have a mortgagee who has a lien upon it to whom it has been paid declared such trustee.

There is not a single element of an estoppel in the whole matter. Neither the laborer nor the material-man acts, or refrains from acting, at the instance of the mortgagee. It is a question of contract between them and the mortgagor in a matter not under the control or supervision of the mortgagee, and rendered with a full knowledge of the mortgagee's lien. It would require affirmative action on the part of the mortgagee, inducing the labor and purchase, to raise an estoppel against him.

The new doctrine is a revolution in jurisprudence, subverting settled principles, and not the application of new remedies to existing rights, and it should be walled into the "exceptional cases" declared to be such by Mr. Justice Brewer in *Kneeland's Case*, 136 U. S. 89, and re-asserted in *Thomas v. Western Car Co.* in 146 U. S. 95.

HEAD, J., concurs in the dissenting opinion.[1]

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[1]A preference in favor of wages, salaries and contracts directly contributing to the conduct of the business is provided for in the corporation law of several states, including N. Y. and Pa.

APPENDIX I

Uniform State Laws Affecting Business

Tables showing: (1) dates of adoption of uniform acts by the national conference of commissioners on uniform state laws; (2) jurisdictions which have thus far enacted such uniform acts, together with the dates of their respective enactments of the acts.

	Negotiable Instruments Act Adopted 1896	Sales Act—Adopted 1906	Warehouse Receipts Act Adopted 1906	Bills of Lading Act Adopted 1909	Stock Transfer Act Adopted 1909	Partnership Act Adopted 1914	Workmen's Compensation Act Adopted 1914	Limited Partnership Act Adopted 1916	Conditional Sales Act Adopted 1918	Fraudulent Conveyance Act Adopted 1918
Alabama	1909		1915							
Arizona	1913	1913							1919	1919
Arkansas	1913		1915							
California	1917		1909	1915						
Colorado	1897		1911							
Connecticut	1897	1907	1907	1911	1917					
Delaware	1911		1917						1919	1919
Florida	1897		1917							
Georgia										
Idaho	1903	1919	1915	1915		1919	1917 Modified	1919		
Illinois	1907	1915	1907	1911	1917	1917		1917		
Indiana	1913						1915			
Iowa	1902	1919	1907	1911				1919		
Kansas	1905		1909							
Kentucky	1904									
Louisiana	1904		1908	1912	1910					
Maine	1917		1917	1917						
Maryland	1898	1910	1910	1910	1910	1916		1918		1920
Massachusetts ..	1898	1908	1907	1910	1910					
Michigan	1905	1913	1909	1911	1913	1917				1919
Minnesota	1913	1917	1913	1917			1913 Modified	1919		

	Negotiable Instruments Act Adopted 1896	Sales Act—Adopted 1906	Warehouse Receipts Act Adopted 1906	Bills of Lading Act Adopted 1909	Stock Transfer Act Adopted 1909	Partnershp Act Adopted 1914	Workmen's Compensation Act Adopted 1914	Limited Partnership Act Adopted 1916	Conditional Sales Act Adopted 1918	Fraudulent Conveyance Act Adopted 1918
Mississippi	1916	1908	1920							
Missouri	1905		1913	1917						
Montana	1903		1917							
Nebraska	1905		1909							
Nevada	1907	1915	1913							
New Hampshire..	1909			1917						1919
New Jersey	1902	1907	1907		1916	1919		1919	1919	1919
New Mexico	1907		1909							
New York	1897	1911	1907	1911	1913	1919				
North Carolina..	1899		1917	1919						
North Dakota...	1899	1917	1917							
Ohio	1902	1908	1908	1911	1911					
Oklahoma	1909									
Oregon	1899	1919	1913				1915			
Pennsylvania ...	1901	1915	1909	1911	1911	1915		1917		
Porto Rico......			1919							
Rhode Island	1899	1908	1908	1914	1912					
South Carolina..	1914									
South Dakota ..	1913		1913						1919	1919
Tennessee	1899	1919	1909		1917	1917		1919		
Texas	1919		1919							
Utah	1899	1917	1911							
Vermont	1912		1912	1915			Yes			
Virginia	1897		1908			1918		1918		
Washington	1899		1913	1915						
West Virginia ..	1907		1917							
Wisconsin	1899	1911	1909	1917	1913	1915		1919	1919	1919
Wyoming	1905	1917	1917			1917				
Alaska	1913	1913	1913	1913	1913	1917		1917	1919	
Hawaii	1907						Yes			
Dist. Columbia..	1899		1910							
Philippine Islands	1911		1912	Yes						

The following is a schedule of the remaining uniform acts so far adopted by the national conference of commissioners on uniform state laws, with the dates of their adoption,

Acknowledgments of Written Instruments Act	1892
Act relating to Wills Executed Without the State	1892
Annulment of Marriage and Divorce Act	1907
Desertion and Non-support Act	1910
Child Labor Act	1911
Marriage and Marriage Licenses Act	1911
Marriage Evasion Act	1912
Cold Storage Act	1914
Foreign Acknowledgments Act	1914
Probate of Foreign Wills Act	1915
Land Registration Act	1916
Extradition Act	1916
Flag Act	1917

None of the foregoing thirteen Uniform Acts has been widely adopted.

APPENDIX II

Subjects of State and Federal Legislation

Congress and the various state legislatures have passed a large number of laws affecting business. The lists below are avowedly incomplete and merely for the purpose of calling attention to the subject-matter of the more important legislation. It should perhaps be mentioned that a multitude of provisions of this sort are incorporated in some of the more recent state constitutions.

A price list of "Laws of United States" will be sent free upon application to the Superintendent of Documents, Government Printing Office, Washington, D. C.

In most states all of the general and permanent laws down to a comparatively recent date have been revised and consolidated, and may now be found in one, or at most, a few volumes. The Acts and Resolves of the legislature subsequent thereto may easily be secured at slight expense. In some instances, the state publishes pamphlet editions of compilations of related laws.

Federal Laws

1. Banking and Currency; National Bank Act, Federal Reserve Act, Farm Loan Act.
2. Bankruptcy Act.
3. Copyright Act.
4. Employers and employees engaged in interstate commerce; Safety-Appliance Act, Employers' Liability Act, Hours of Service Act, Mediation and Arbitration Act.
5. Pure Food and Drug Act.
6. Immigration Act.
7. Interstate commerce regulation for protection of the public; Interstate Commerce Act, Bills of Lading, Liability of Carriers; Transportation Act.
8. Navigation and shipping laws; carriers of goods by water; carriers of persons by water.
9. Patent laws.
10. Tariff and taxation laws.
11. Trade-Mark Act.

12. Trusts and monopolies engaged in interstate and foreign commerce; Sherman Anti-Trust Act, Trade Commission Act, Clayton Act, Webb-Pomerene Act.

State Laws

1. State Banks and Trust Companies.
2. Railroads and Public Utilities.
3. Insurance Companies.
4. Business Corporations.
5. Limited Partnerships.
6. Regulations of Occupations and Businesses by the Issuance of Licenses, etc.
7. Landlord and Tenant.
8. Married Women's Act.
9. Foreign corporations.
10. Labor legislation: Hours of labor of women and children; payment of wages; minimum wage; assignment of wages; factory legislation in the interest of health and safety; Employers' Liability Act; Workmen's Compensation Act; Arbitration of Industrial Disputes.
11. Taxation.
12. Pure Food and Drug Laws.
13. Anti-trust Acts.
14. Fictitious Names Act.
15. False Statement Act.
16. General assignments for the benefit of creditors and receiverships for insolvent corporations.
17. Liens of mechanics and materialmen.
18. Chattel mortgages and conditional sales.
19. Negotiable Instruments.
20. Sales of goods, including legislation on factors, bills of lading, warehouse receipts and bulk sales.
21. Statute of Frauds.
22. Interest and usury statutes.
23. Statute of Limitations.
24. Exemption Laws.
25. Observance of Lord's Day.
26. Forms of deeds of real estate and their acknowledgment.
27. Foreclosure of mortgages on real estate.
28. Blue Sky Laws.

Ordinances Enacted by Local Governing Bodies

Traffic, health and building regulations; Licensing of occupations.

INDEX

(References are to pages.)

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